KONINKLIJKE PHILIPS ELECTRONICS NV
Form 6-K
February 19, 2008

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K
REPORT OF FOREIGN ISSUER
Pursuant to Rule 13a-16 or 15d-16 of the
Securities Exchange Act of 1934
For the period commencing January 29 through February 18, 2008

KONINKLIJKE PHILIPS ELECTRONICS N.V.
(Exact name of registrant as specified in its 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 offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F þ Form 40-F o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule101(b)(1):___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule101(b)(7): ___

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No þ

Name and address of person authorized to receive notices
and communications from the Securities and Exchange Commission:
E.P. Coutinho
Koninklijke Philips Electronics N.V.
Amstelplein 2
1096 BC Amsterdam The Netherlands

This report comprises a copy of the *Annual Report of the Philips Group* for the year ended December 31, 2007, dated February 18, 2008, as well as copy of the press releases entitled:

Philips extends tender offer period to acquire Respironics , dated February 4, 2008;

Mr. Jan-Michiel Hessels to succeed Mr. Wim de Kleuver as Supervisory Board Chairman of Royal Philips , dated February 18, 2008.

Table of Contents

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf, by the undersigned, thereunto duly authorized at Amsterdam, on the 18th day of February 2008.

KONINKLIJKE PHILIPS ELECTRONICS N.V.

/s/ G. J. Kleisterlee

(President,
Chairman of the Board of Management)

/s/ P. J. Sivignon

(Chief Financial Officer,
Member of the Board of Management)

Table of Contents

Simpler, stronger, better
Annual Report 2007

Table of Contents

Philips taps teams of futurists, cultural anthropologists, designers and scientists to develop user-centered products and services.
BusinessWeek.com, 9/10/07

BusinessWeek innovation ranking

In the BusinessWeek-Boston Consulting Group s annual ranking of the world s most innovative companies, Philips jumped from No. 67 in 2006 to No. 38 in 2007.

Awards

In 2007 we received over 45 design awards recognizing our commitment to people-focused solutions. These included 16 coveted iF awards. We also won two prestigious awards from the European Imaging & Sound Association (EISA). The 47PFL9732D FlatTV with Ambilight was named *European Full-HD LCD TV 2007-2008,* while the HTS8100 SoundBar DVD Home Theater with Ambisound technology was named *European Home Theater Compact* System *2007-2008.*

Simplicity Event 2007

Philips Simplicity Events use simplicity-led design concepts to provide an insight into possible solutions three to five years ahead. The 2007 edition in London showcased how the inventive use of technology, coupled with intuitive, personalized design, can enhance care for people s well-being at home, in the hospital and on the move.

...they are at the heart of our thinking

Live Earth / asimpleswitch.com

On July 7,2007, Philips sponsored the Live Earth concerts at eight different locations around the world, attracting an audience of two billion people. On the asimpleswitch.com website, over 600,000 people have pledged to replace a total of over 3.3 million light bulbs with energy-efficient alternatives.

56%

Sales of innovative products

In 2007,56% of our sales came from products introduced in the last three years.

500 million and counting

In May 2007 our 500 millionth shaver was produced in Drachten (Netherlands). We also ushered in the future of shaving with the launch of the revolutionary Arcitec shaver. With its ergonomic design and three independently flexing heads, Arcitec offers optimum skin contact in curved areas for a faster, closer, more efficient shave.

Philips not only talks simplicity, it lives simplicity

Dr Jurgen Hausler, [ILLEGIBLE]

CEO Interbrand Zintzmeyer & Lux

Interbrand ranking

Philips was one of the ten fastest-growing brands in terms of total brand value in the 2007 ranking of the top-100 global brands as compiled by leading brand consultant Interbrand. Our brand value rose 15% to an estimated USD 7.7 billion, making Philips the 42nd most valuable brand in the world.

Table of Contents

We are inspired by people

World of wonder

Philips has redefined home entertainment with Aurea. The Aurea experience is like stepping into a different world, as scenes radiate an aura of light and color beyond the frame. The result is a totally immersive, ambient viewing experience.

Better images, lower impact

The 256-slice Philips Brilliance iCT scanner can capture an image of the entire heart in just two beats, while reducing radiation doses by up to 80%.

Energy-saving potential

Designed for offices and schools, for instance, Philips MASTER TL-D Eco fluorescent lamps save 15% energy compared to traditional T8 fluorescent lamps, of which the EU alone has an installed base of more than 1 billion.

Table of Contents

This Annual Report is available online   in dynamic, interactive form   at the address below. Key financial data are available as Excel downloads. The Report can also be downloaded in full or per chapter in PDF.

www.philips.com/annualreport

In parallel and complementary to this Annual Report 2007, we have published our Sustainability Report 2007 (www.philips.com/sustainability).

Forward-looking statements

This document 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 the Outlook section of the chapter The Philips Group in this Annual Report. Examples of forward-looking statements include statements made about our strategy, estimates of sales growth, future EBITA and future developments in our organic business. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances and there are many 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. As a result, Philips   actual future results may differ materially from the plans, goals, and expectations set forth in such forward-looking statements. For a discussion of factors that could cause future results to differ from such forward-looking statements, see also the chapter Risk management.

Third-party market share data

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.

Fair value information

In presenting the Philips Group   s financial position, fair values are used for the measurement of various items in accordance with the applicable accounting standards. These fair values are based on market prices, where available, and are obtained from sources that are deemed to be reliable. Readers are cautioned that these values are subject to changes over time and are only valid at the balance sheet date. When a readily determinable market value does not exist, fair values are estimated using valuation models, which we believe are appropriate for their purpose. They require management to make significant assumptions with respect to future developments which are inherently uncertain and may therefore deviate from actual developments. Critical assumptions used are disclosed in the financial statements. In certain cases, independent valuations are obtained to support management   s determination of fair values.

US GAAP basis of presentation

The financial information included in this document is based on US GAAP, unless otherwise indicated. As used in this document, the term EBIT has the same meaning as Income from operations (IFO).

Use of non-US GAAP information

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; EBITA; NOC; net debt (cash); 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 measures.

Further information on non-US GAAP information and a reconciliation of such measures to the most directly comparable US GAAP measures can be found in the chapter Reconciliation of non-US GAAP information.

Statutory financial statements and management report

The chapters IFRS financial statements and Company financial statements contain the statutory financial statements.

The introduction to the chapter IFRS financial statements sets out which parts of this Annual Report form the management report within the meaning of Section 2:391 of the Dutch Civil Code (and related Decrees).

Reclassification

On November 2, 2007, Philips announced that it has decided to proceed with the sale of its approximately 70% ownership interest in MedQuist. Amongst others, in order to ensure comparison between different financial years and to achieve optimal transparency for users of the Annual Report, all consolidated financial statements of prior years have been restated to present the MedQuist business as a discontinued operation. The original consolidated financial statements of prior years are available on the Company s website.

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.

Contents

8 Financial highlights
10 Message from the President
The Philips Group
16 The Philips Way
34 Management discussion and analysis
48 Liquidity and capital resources
54 Acquisitions
58 Other information
60 Proposed dividend to shareholders
61 Outlook
The Philips sectors
62 Our structure
64 Medical Systems
70 Domestic Appliances and Personal Care
76 Consumer Electronics
82 Lighting
88 Innovation & Emerging Businesses
95 Group Management & Services
98 Risk management
112 Our leadership
116 Report of the Supervisory Board
Financial statements
127 Notes overview
Group financial statements
128 Management s report
129 Auditors report
130 Consolidated statements of income
132 Consolidated balance sheets
134 Consolidated statements of cash flows
136 Consolidated statements of stockholders equity
137 Information by sectors and main countries
140 Significant accounting policies
146 Notes to the group financial statements
IFRS financial statements
189 IFRS management commentary
194 Consolidated statements of income
196 Consolidated balance sheets
198 Consolidated statements of cash flows
200 Consolidated statements of equity
202 Information by sectors and main countries
205 Significant IFRS accounting policies
211 Notes to the IFRS financial statements
239 Auditor s report
Company financial statements
240 Balance sheets
241 Statements of income
241 Statement of equity

243 Notes to the company financial statements
245 Auditor s report
246 Reconciliation of non-US GAAP information
250 Corporate governance
258 The Philips Group in the last ten years
260 Investor information

Table of Contents

Financial highlights

all amounts in millions of euros unless otherwise stated	2005[1]	2006[1]	**2007**
Sales	25,445	26,682	**26,793**
EBITA[2]	1,652	1,386	**2,065**
as a % of sales	6.5	5.2	**7.7**
EBIT	1,558	1,201	**1,852**
as a % of sales	6.1	4.5	**6.9**
Results relating to equity-accounted investees	1,754	(157)	**763**
Income from continuing operations	2,879	901	**4,601**
Income (loss) from discontinued operations	(11)	4,482	**(433)**
Net income	2,868	5,383	**4,168**
per common share in euros			
- basic	2.29	4.58	**3.84**
- diluted	2.29	4.55	**3.80**
Net operating capital[2]	5,439	8,518	**10,586**
Cash flows before financing activities[2]	2,841	(2,472)	**5,449**
Stockholders equity	16,666	22,997	**21,684**
Net debt : group equity ratio[2]	(4):104	(10):110	**(32):132**
Employees at December 31 [3]	159,226	121,732	**123,801**

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

2) For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information

3) Includes discontinued operations 44,174 at December 31,

2005,6,640 at
December 31,
2006 and 5,703
at December 31,
2007

Table of Contents

98 Risk management | 112 Our leadership | 116 Report of the Supervisory Board | 126 Financial Statements

5%	**1.90**	**7.7%**	**4,168**
comparable sales growth	EBITA per common share	EBITA as a % of sales	net income in millions of euros

Message from the President

Dear shareholder,

2007 was a dynamic and exciting year for our company, with good progress on many fronts. However, this did not translate into an equally exciting share performance. Operationally, we delivered once again on our Group targets, with 5% comparable sales growth and an EBITA margin of 7.7%, thanks to good execution, a strong innovation pipeline and a balanced portfolio that proved its robustness in a weakening economic environment.

We continued to advance well in our drive to become a truly market-focused, people-centric company that is geared to creating value through sustained profitable growth.

Strategically, we made significant steps in building strong market leadership positions across the portfolio, by investing in high-growth high-margin businesses while continuing to divest some low-growth low-margin businesses, largely completing our portfolio transformation.

In particular, the announced acquisitions of Genlyte and Respironics will boost our leadership position in Lighting and Home Healthcare respectively.

At the same time, we also tightened the focus of our portfolio with, among others, the sale of our mobile phone operation, as well as the projected divestment of our set-top box activity and our ownership interest in MedQuist.

We continued to invest in strengthening our position in important emerging markets in Asia, Eastern Europe and Latin America. Across our businesses, growth in emerging markets was particularly strong in 2007, and they now account for approximately 30% of our sales. We intend to further expand our presence in these markets by growing considerably faster than their respective economies.

We also continued to invest heavily in the things that really set Philips apart our brand and our end-user-driven innovation and design moving us to 38th place in *Business Week s* ranking of the world s most innovative companies (up from 67th place in 2006) and further increasing our brand value by 15% (according to Interbrand).

Financially, we accelerated our disciplined redeployment of capital with the announcement of a new EUR 5 billion (tax-free) share repurchase plan, on the back of a change to Dutch tax law. At the same time, we moved forward with our program to sell down our financial holdings, lowering our stakes in TSMC and LG.Philips LCD. With our capital reallocation process now largely completed, we are well on our way to arriving at an efficient balance sheet before the end of 2009.

In 2007 we also launched our EcoVision IV program, which aims to double sales of our Green Products over the next five years to 30% of total revenues, in comparison to 15% in 2006. And we have pledged to double investments in green innovations to EUR 1 billion by 2012. Concentrating on areas where we can make an impact with our capabilities and expertise, we are focusing our sustainability efforts on two global challenges: energy efficiency and available and affordable healthcare.

Crucially, in September we announced Vision 2010, a strategic blueprint defining the company we want Philips to be a simpler, stronger company that is better placed to meet people s need for high-quality but affordable healthcare, energy-efficient lighting and rewarding lifestyle experiences, while at the same time providing significant shareholder value by delivering on our target to double EBITA per share by 2010.

As stated above, good progress on many fronts, though for you, our shareholder, only a flat share price performance, more or less in line with the market. With that, we rank on three-year TSR (Total Shareholder Return) 5th in our old peer group of 24 companies and, for the first time in our new peer group, 6th among 12

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

companies. Our ambition and your expectation are clearly higher, and so with our agenda for 2008 we will drive even more relentlessly for value creation and delivery.

Performance against targets

As I do every year, I would also like to update you on how we did on the things we had set out to do as part of our 2007 Management Agenda.

Maintain annual average sales growth of 5-6% and achieve above 7.5% EBITA

I am glad to say we achieved our Group targets of 5-6% annual average sales growth and EBITA above 7.5%.

At 5%, comparable sales growth was at the low end of the bandwidth as particularly high growth at DAP and solid growth at Lighting were offset by a flat performance at Consumer Electronics, caused by a loss of market share in the first half of the year at Connected Displays a highly competitive business that we continue to manage for profitability while Medical Systems sales growth was hampered by a declining US imaging market, triggered by the Deficit Reduction Act.

At 7.7% of sales, our EBITA margin is the highest in recent years, up from 5.2% in 2006 an excellent starting position towards our 2010 targets. Operationally, we executed very well in our DAP and Lighting businesses, which achieved EBITA margins of 17.6% and 11.9% respectively, even though Lighting was hampered by the sharp decline in the very profitable UHP business and the closure of our LCD backlighting activity. However, we had some issues at Consumer Electronics, especially Connected Displays, with losses in the US for the whole year. Despite this, Consumer Electronics managed to exceed its target of 3% EBITA margin. At Medical Systems we were impacted by the slowdown of the US imaging market. The shortfall in the US could not be compensated entirely by a good operational performance of the non-imaging businesses and in the rest of the world, which resulted in slight under-performance against margin targets, EBITA remaining virtually stable at 13.5%.

Delivering on our 2007 objectives puts us in a good starting position to meet the more ambitious medium-term targets set as part of Vision 2010, especially as this portfolio of activities has shown resilience in earlier periods of economic downturn.

Continue to redeploy capital in a disciplined way through value-creating acquisitions, share buy-backs and dividends

In 2007 we continued to further strengthen our key businesses and create true market leadership positions by means of both small fill-in and larger platform acquisitions all high-growth high-margin businesses.

Besides our acquisition drive, which resulted in 2007 in a total cash-out of EUR 1.5 billion, we continued our policy of repurchasing shares, buying back some EUR 1.6 billion worth of shares, of which EUR 0.8 million for cancellation. Unfortunately the buy-back through the so-called second trading line brought us only about half of the EUR 1.6 billion we had targeted. However, on the back of a change to Dutch tax law, we were able, in December, to announce a new EUR 5 billion buy-back plan, through which we will more than catch up on our target.

With our year-end announcements of the Respironics acquisition and our latest share buy-back plan, we passed the EUR 10 billion mark twice for closed and announced acquisitions, as well as for the total of realized and intended share buy-backs. In total we have re-allocated over EUR 20 billion of capital since 2005, largely completing our capital re-allocation program and putting us well on track to deliver, as promised, an efficient balance sheet before the end of 2009.

With our strong focus on economic value added as well as return on invested capital, our projections show that

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Our sectors share a common brand that stands for innovation delivered with sense and simplicity .

this combination of accretive acquisitions and share buy-backs is the best way to create shareholder value.

I am also pleased to announce that, consistent with our policy to pay out 40-50% of continuing net income as an annual dividend, we are proposing to the upcoming General Meeting of Shareholders to declare a dividend of EUR 0.70 per common share, an increase for the fourth year in a row and a statement of our confidence for the future.

Drive a culture of superior customer experience by delivering on the brand promise and implementing the Net Promoter Score measure in the company

In 2007, Philips was one of the ten fastest-growing brands in terms of total brand value in the annual ranking of the top-100 global brands compiled by Interbrand a clear sign that the brand s core messages resonate with customers. Our brand value rose 15% to an estimated USD 7.7 billion, making Philips the 42nd most valuable brand in the world.

We drove the further deployment of the Net Promoter Score (NPS) as our single key metric of customer experience. NPS measures the answer to just one question: How likely is it that you would recommend this company/ product to a friend or colleague? Brands with high NPS scores tend to grow faster and more profitably than their competitors. At present, close to 50% of our key businesses have industry-leading scores, and we aim to increase this figure to 70% by 2010 a significant but vital challenge.

Be an exciting place to work and bring employee engagement to a high-performance benchmark level within 2 to 3 years

Philips is a fantastically exciting place to work. We offer our employees excellent working conditions, energizing career challenges and international development opportunities. And we are unstinting in our efforts to create a diverse and inclusive working environment, in which all employees feel valued for their talents and contribution.

We are also stimulating a culture where people are encouraged to be ambitious and take calculated risks, and where failure is understood to be part of learning.

We measure the progress of our people initiatives through our annual Employee Engagement Survey. In 2007, the response was 92%, up from 85% in 2006, and the results show definite improvement. The Employee Engagement Index figure rose to 64%, from 61% in 2006. Our goal is to reach the high-performance benchmark of 70% by 2009.

We also use the Engagement Survey to gauge how our people judge their leaders. Our People Leadership Index measuring 12 aspects relating to one s direct manager-rose to 64% from 59% in 2006, equally moving towards the high-performance benchmark of 70%.

Vision 2010 creating a simpler, stronger and better company

In September 2007 we launched Vision 2010, organizing Philips in three market-oriented sectors - Healthcare, Lighting and Consumer Lifestyle effective January 2008, with the ambition to build a company with a significantly higher shareholder value by delivering on our target to double EBITA per share by 2010 from our 2007 starting point

Vision 2010 represents a step up of ambition in our drive to become a truly market-driven, people-centric company with a well-balanced portfolio of professional and consumer businesses with attractive EBITA margins and effective business models one that has already demonstrated resilience in a challenging economic environment

Our sectors address specific yet interlinked markets, with a strong focus on people and their health and well-being, and they share a common brand that stands for innovation delivered with sense and simplicity .

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

Healthcare

Our new Healthcare sector brings together Medical Systems and our growing Home Healthcare Solutions business formerly Consumer Healthcare Solutions. We now deliver innovative solutions based on the combination of human insights and clinical expertise-across the entire care cycle, from the hospital to the home. We believe the link bridging the hospital and the home is going to be increasingly important in delivering better patient outcomes while containing costs.

In the hospital market we strengthened our global leadership in critical care with the acquisition of VISICU, providing advanced IT solutions for monitoring of patients in the intensive care unit.

Complementary to our established leadership position in the professional healthcare technology market, our proposed acquisition of Respironics a leading US-based global provider of innovative respiratory and sleep therapy solutions for hospital and home use is part of our strategy to create a global leadership position in the fast-growing home healthcare solutions market as well. Given the unsustainably high healthcare costs in many markets and increased emphasis on both efficiency and patient comfort, we are seeing 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. With our expertise in consumer insights in the consumer lifestyle space, we feel we are ideally positioned to be one of the leading companies driving this emerging trend.

Completion of this stage of our acquisition drive will create a Healthcare sector with sales of over EUR 7 billion going forward and global leadership positions in areas such as cardiac care, acute care, and now also home healthcare. We will continue to grow our business organically and further expand profitability by maintaining our focus on operational excellence and by leveraging our 2007 acquisitions.

Lighting

In both the professional and consumer domains, Philips Lighting is increasingly shifting its focus towards applications, rather than products, supported by the growing demand for energy-efficient solutions and the rise of solid-state lighting. In 2007 we underscored our ambitions by completing a number of major acquisitions totaling EUR 1.2 billion to boost growth and position ourselves for the future.

Table of Contents

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

We completed the acquisition of Partners in Lighting International, the leading European manufacturer of home luminaires, an area where solid-state lighting (SSL) will bring major benefits in terms of creating atmospheres and reducing energy consumption.

Further lighting acquisitions included Color Kinetics, a US-based leader in innovative LED lighting systems, with 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.

Toward the end of the year we announced the acquisition of major North American luminaire manufacturer Genlyte, giving us the leading position in the US market for professional lighting applications.

Together, these actions have significantly strengthened our global leadership position in the market for advanced, energy-efficient lighting solutions, creating a Lighting sector with sales of over EUR 7 billion going forward. Leveraging end-user-driven innovation, marketing and supply excellence, we will drive profitability by managing for growth.

Consumer Lifestyle

Combining CE and DAP s complementary strengths will boost Philips consumer lifestyle proposition as a whole, creating a new business sector based on deep end-user insight, cutting-edge design and rich consumer experiences, rather than product categories.

In Consumer Lifestyle we have chosen a strategic direction which is based on the fundamental insight that our target customer is increasingly interested in personal well-being. Exploiting Philips innovative capability, brand and distribution strength will enable Consumer Lifestyle to further drive the portfolio in the direction of sustainable high-margin positions in the well-being space, as well as providing us with a platform to grow into new value spaces. At the same time, the coming year will see us take decisive steps to structurally deal with the issue of unsatisfactory profitability at Connected Displays.

Focus on execution

We are close to being the Philips we envisaged when we set out to transform the company in 2001. We are no longer inward-looking, but market and customer-oriented, no longer volatile and cyclical, but ready to continue to progress in spite of economic headwind. I am convinced that unrelenting focus on the needs of the market, along with rigorous and consistent execution of our plans, will enable us to continue delivering on our promise of sustained profitable growth.This will bring us a step closer to the realization of our Vision 2010 ambition and create lasting value for all our stakeholders and in particular for you, our shareholder.

Final thoughts

On a personal note, I would like to thank Theo van Deursen, who will be retiring on April 1 this year, for his outstanding contribution over a period of some 35 years, latterly as CEO of Philips Lighting, where he has been the architect and driving force of the new, expanding Lighting sector. I wish him all the best for his retirement

With Rudy Provoost we have a good successor for Theo, one who will steer the next phase of growth and expansion at Philips Lighting, having profoundly transformed our Consumer Electronics businesses. I am also very pleased to have Andrea Ragnetti as the leader of our Consumer Lifestyle sector, where he will combine his marketing skills with the best of DAP and CE. Together with Steve Rusckowski s in-depth knowledge and experience of Healthcare, we have three strong sector leaders working closely together with me and my colleagues Pierre-Jean Sivignon and Gottfried Dutiné to provide Philips with the leadership it needs to move to a higher performance level.

We also have to say goodbye to Wim de Kleuver, the Chairman of our Supervisory Board, whose stewardship, wisdom and experience we have always valued. I wish him the very best for the future.

Finally, on behalf of the entire Board of Management, I would like to express my thanks to you, our shareholders, for your continued support as we strive supported by the dedication and drive of our people to fulfil the promise of the future set out in Vision 2010.

Gerard Kleisterlee

President

Table of Contents

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

The Philips Way

Our company was founded in Eindhoven (Netherlands) in 1891 to manufacture incandescent lamps and other electrical products . Ever since then, we have been simplifying and enhancing people s lives with a steady flow of pioneering innovations, for instance in the fields of medical imaging, television, lighting, optical technology and integrated circuits. Today, we remain committed to building upon this rich heritage to make people s lives simpler, more enjoyable and more productive.

Vision 2010

In 2001 we started out on a journey to transform Philips into a focused, market-driven company capable of delivering sustained profitable growth, and so creating value for our stakeholders. Over the course of the intervening years, we have fundamentally repositioned Philips from a rather volatile, technology-focused, vertically integrated electronics company to an applications-oriented, customer-centric and more predictable company. This involved a massive capital re-allocation, away from cyclical technology businesses and toward expansion of our high-margin core businesses through acquisitions, innovation and brand injections, as well as returning capital to shareholders through tax-efficient share buy-backs and dividends. In 2007 we took another major step forward with the announcement of our Vision 2010 strategic blueprint.

Vision 2010 places the customer at the very heart of everything we do. Accordingly, we have realigned our entire organization around the needs we see in the marketplace. Effective January 1,2008, we now have three sectors Healthcare, Lighting and Consumer Lifestyle.

Insights and empowerment

Our mission is to improve the quality of people s lives through the timely introduction of meaningful innovations. In a world where complexity grows to touch every aspect of our daily lives, we will lead in bringing sense and simplicity to people.

Based on a deep understanding of what people really need and want, and delivering on our promise of simplicity, we empower our customers both healthcare and lighting professionals and end-consumers with solutions that are advanced, yet designed around them and easy to experience. Specifically, we address these needs and desires in the four domains of *my space, my body, my appearance* and *my mind.*

As well as expressing a commitment to eliminate unnecessary complexity and to deliver the meaningful benefits of technology, our sense and simplicity brand promise also defines how we want to be seen by all our stakeholders open and transparent, approachable, easy to do business with.

Today, Philips is a much simpler company focused on the market, centered around the brand and driven by innovation. We see tremendous potential in both mature and emerging markets and leverage our competencies in design, technology and marketing to capture value from some of the major economic, social and demographic trends, e.g. the growing demand for better healthcare at lower cost consumer empowerment the rise of emerging markets and the need for energy efficiency.

Table of Contents

As we strive to enhance the quality of people s lives, our 7 strategic drivers are helping us become a simpler stronger and better company.

Vision 2010 ambition to significantly increase shareholder value

Improve the EBITA margin of our current businesses to exceed 10% by year-end 2010

Through improved margin management, increased contribution from recent acquisitions, a better product mix, the effects of the organizational simplification and reduced corporate brand spend.

Drive comparable sales growth at a minimum of 6% (compound annual growth rate) for the period 2008-2010

Fuelled by organic growth, and through a specific focus on emerging markets and developing economies.

Arrive at an efficient balance sheet by the end of 2009

Through a combination of further value-creating acquisitions and continued return of capital to shareholders.

Thanks to the combined effect of these measures, we expect EBITA per common share to more than double by 2010 from the 2007 level.

Management Agenda 2008

As a result of a thorough review of our 2007 achievements and remaining challenges, as well as our expectations for the development of the global economy and the competitive environment, we have adopted the following management agenda for 2008:

Integrate and leverage recent acquisitions, delivering the anticipated return on investment

Take decisive steps to structurally deal with unsatisfactory EBITA margins at Connected Displays

Improve productivity as a driver of margin expansion

Step up resource investment in emerging markets to accelerate growth in excess of 2x GDP

Increase innovation focus in support of Philips growth ambition

Continue to drive a culture of superior customer experience

Bring employee engagement to high-performance benchmark

Table of Contents

Our 7 strategic drivers

1

We are a people-centric company that organizes around customers and markets

Vision 2010 positions Philips as a market-driven company with an organizational structure that reflects the needs of its customer base.

Our three new sectors, Healthcare, Lighting and Consumer Lifestyle, each address different markets, but have one thing in common the customer is at the center.

By bringing together Medical Systems and our growing Home Healthcare Solutions business, for example, we can develop solutions that deliver value throughout the complete cycle of care from disease prevention to screening and diagnosis through to treatment, monitoring and health management.

And by combining CE and DAP, we will leverage our competencies to create competitive advantages in a challenging marketplace. Merging sales teams, for example, will create greater focus and reach within our chosen markets. Optimizing supply and service processes will improve customer-centric effectiveness. And combining consumer insights will enable us to deliver even more compelling value propositions.

2

We invest in a strong brand and consistently deliver on our brand promise of sense and simplicity in our actions, products and services

The 2007 wave of our brand campaign showcased a range of simplicity solutions that empower consumers, particularly families, to manage their health and well-being. These advertisements underscore the deep consumer knowledge and insights that set Philips apart in the healthcare industry.

By investing consistently in our brand also through activities like our Simplicity Events we are seeing its value increase significantly, as evidenced by our fourth successive rise in the annual Interbrand top 100.

3

We deliver innovation by investing in world-class strengths in end-user insights, technology, design and superior supplier networks

Technology continues to drive many of our innovations, and innovation is integral to everything we do. But to ensure it is relevant and meaningful, we take end-user insights as its starting point.

Product creation and development begins with an understanding of people s needs and aspirations. We make extensive use of our Experience Labs, where we can study people interacting naturally with our product concepts. If they find the concepts too complex, we make them simpler or go on to the next innovation.

The Philips Wake-Up Light is a new, medically proven wake-up solution based on the simulation of dawn. It emits light that gradually increases to the intensity you have selected, gently preparing your body to wake up. This dawn light positively affects your energy hormones, enabling you to rise naturally and easily, feeling energized and refreshed.

4

We develop our people s leadership, talent and engagement and align ourselves with high-performance benchmarks

In the 2007 edition of our annual Employee Engagement Survey, almost 100,000 Philips employees from across all sectors and functions were invited to answer the same 39 questions on leadership, management capabilities, alignment with Philips vision, identification with the brand, and reward recognition.

The Employee Engagement Index figure increased to 64%, from 61% in 2006. We have set ourselves the goal of reaching the high-performance norm of 70% by 2009. So while we are on the right track, the remaining gap still needs to be closed.

5

We invest in high-growth and profitable businesses and emerging geographies to achieve market leadership positions

We are well positioned to benefit from major trends that will determine global GDP development in the coming decade, i.e. the need of a growing and longer-living population for more and affordable healthcare, the need for energy-efficient solutions (e.g. for lighting) and developments in the consumer space. We are also well placed to realize profitable growth in emerging markets, while contributing to the sustainable development of these economies.

We continue to pursue opportunities to make value-creating acquisitions that can further our growth ambitions. The acquisitions we announced in 2007, for example, strengthened or established our leadership positions in promising markets, or gave us access to new markets. The successful integration of Partners in Lighting International, Color Kinetics and Genlyte will significantly boost our global leadership position in the market for advanced lighting solutions, while the announced acquisition of Respironics puts us firmly at the forefront of the fast-growing market for home healthcare solutions.

Now, the priority is to successfully integrate and leverage these acquisitions in order to capture their full value and so deliver the anticipated growth and margins.

6

We are committed to sustainability and focus on making the difference in efficient energy use

Global climate change, rising energy costs and pressure to meet targets on reduction of CO_2 emissions are major issues facing the world today. Addressing these imperatives and the opportunities they present will have a major impact on global business.

Philips has a long-standing commitment to providing solutions that improve people s lives and are environmentally sound. Now we are the industry leader in energy-efficient lighting with, for example, our state-of-the-art TL5 lamps and LED light sources, electronic gear, high-efficiency optics and energy-saving lighting controls.

We are aiming for our Green Products to generate 30% of total revenues by 2012, compared with 15% of Group sales in 2006. This commitment is part of our latest EcoVision program, which aims to double investment in green innovations to EUR 1 billion in the next five years and to increase the energy efficiency of our operations by 25%. During 2007 we launched our Green Logo, a simple tool to help consumers find Philips Green Products in stores and make responsible choices.

7

We drive operational excellence and quality to best-in-class levels, allowing us to make strategic investments in our businesses

Philips Business Excellence (PBE) provides a holistic framework for assessing an organization s position relative to world-class performance, identifying strengths as well as improvement opportunities that support business objectives. In few areas are the demands for manufacturing excellence higher than in the automobile industry. This drives our Automotive Lighting business, which has adopted a zero-defects policy not as a philosophy but as a hard target. Using the Philips Business Excellence program, our people at Automotive Lighting identify what improvements are needed, and formalize them in the management agenda. The policy is based on management attention and shop floor focus. Black Belts (process experts) and Green Belts (operational and tactical experts) lead improvement teams focused on product quality issues. Our Lighting Quality Improvement Competition provides a platform where the teams can share their experiences and learn from each other, as well as motivating and engaging our people.

Table of Contents

I feel more secure now

Philips and healthcare

I live on my own and have severe arthritis, which makes me fall sometimes. Now, I can get help when I need it. When I fell last week I pressed the button, and immediately my panic was gone. Within a few minutes the paramedics were here.

Philips Lifeline is an easy-to-use personal response service that lets you summon help any time of the day or night even if you can t speak. All you have to do is press your personal help button, worn on a wristband or pendant, and a trained response center associate will ensure you get help fast.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

The Philips Way

Healthcare

Our focus is on the people at the center of healthcare the patient and the care provider. Based on both user insights and clinical excellence, our innovative solutions simplify and improve care, and empower people to manage their own health.

Whether in the hospital or the home, we seek to improve patient outcomes throughout the entire care cycle from prevention and screening to diagnosis, treatment, monitoring and management.

Patient comfort

The Philips Panorama HFO magnetic resonance system provides high-quality performance in a truly open configuration, allowing three times more patient space than cylindrical high-field systems. This creates a more acceptable imaging environment for claustrophobic or anxious patients.

For demanding caseloads

Philips X-ray angiography systems - such as the Allura Xper range deliver flexibility and workflow control, while ensuring exceptional image quality and superb dose management. Designed for cardiac, vascular and neuro interventions, these systems help increase clinical efficiency.

Get closer

The Philips BrightView SPECT system offers exceptional image quality in a fast, easy-to-use package. Its BodyGuard feature automatically contours to the patient, using a customizable scan distance preset by the operator.

Anytime, anywhere

Philips iSite PACS is an enterprise-wide medical image and information management system. From an easy-to-use interface to having all images archived online and available at the click of a mouse, iSite PACS delivers the power of radiology to the point of patient care.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Addressing daily challenges

With its image quality, ease of use, automated quantification and workflow solutions, the Philips iU22 intelligent ultrasound system gives clinicians tools that increase confidence in diagnoses and improve throughput.

Quality gains

The Philips Gemini PET/CT scanner with TruFlight technology delivers 20% better spatial and contrast resolution, providing faster, more sensitive scanning than conventional PET. This facilitates earlier disease detection, regardless of patient size.

Delivering clear information

The Philips IntelliVue family of patient monitors gives care teams throughout the hospital more of the information they need right at the patient s side. All share a common user interface and Philips innovative portal technology.

Superior imaging

Philips Brilliance CT systems provide the clinical advantages needed to attract referrals and the productivity advantages needed to keep them. Their appeal is powered not only by technological innovations for superior speed, accuracy and reliability, but also by advances in user interaction.

Care in the home

Philips Remote Patient Management has a comprehensive offering of telehealth products and services for monitoring of chronically ill patients after they have been discharged from hospital.

People-focused healthcare

Philips Ambient Experience integrates design and enabling technology to provide each patient with a personalized experience that eases anxiety, thereby facilitating procedures and increasing operational effectiveness.

Table of Contents

.

I can create different moods now

Philips and lighting

My shop is constantly changing in terms of merchandise, theme, floor layout, etc. And my customers motivation or mood for shopping can be different at different times. Now, I can tailor the ambience to my clientele at the touch of a button, or adapt the lighting to events such as a summer sale or the launch of a new collection.

Philips AmbiScene is a flexible lighting concept designed to help retailers create inspiring and meaningful shopping experiences. It can change the lighting in every conceivable way (e.g. color, tones of white, intensity), addressing different shopping moods and supporting retail communication strategies. AmbiScene comprises a broad portfolio of luminaires and controls, including solid-state lighting, allowing dynamic lighting and special effects.

The Philips Way

Lighting

Lighting has a major impact on our well-being, moods and emotions. It inspires, attracts, communicates, sets the scene and enhances our experience of architectural spaces.

Combining our understanding of people s needs, desires and aspirations with our technological leadership, we are able to deliver the advanced, energy-efficient products and systems that will help us create a sustainable future.

Safer driving

A study by the independent safety research organization TÜV Rheinland showed that if all vehicles on German roads were equipped with Xenon car lights, 18% of all fatalities could be avoided, saving 1,200 lives annually.

Enjoy your stay!

Philips MASTERCIassic is a retrofit halogen bulb for hospitality applications, which cuts energy consumption by 50%, lasts three times longer than an incandescent bulb and provides outstanding sparkling white light.

Living streets

Philips CosmoPolis delivers a very high-quality white light and uses 50% less energy than the mercury-vapor street-lighting systems still in use all over the world, saving more than 100 kg of CO_2 per year per lamp.

Simply irresistible

Philips MASTERColour COM Elite s crisp white light, high output and superior color rendering adds sparkle to retail environments, displaying merchandise to best effect and attracting consumers.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Cities for people

Offering unprecedented design freedom in terms of color, dynamics, miniaturization and energy efficiency, solid-state lighting is bringing towns and cities to life in ways we could previously only dream of.

The thrill of the action

Philips ArenaVision was the world s first sports-lighting system specifically designed to increase dramatically the theatrical and emotional value of sports for TV audiences, spectators and players alike.

Home comforts

Philips Mini Softone is the first range of energy-saving lamps with the size, shape, warm light quality and output required for decorative lighting fixtures in the home.

Smart energy saving

Philips ActiLume is an intelligent lighting control for offices. It detects when people are present and switches the lights on or off accordingly. It also dims the lights when there is sufficient incident daylight. In this way, energy savings of up to 75% can be realized.

Table of Contents

We feel healthier now

Philips and lifestyle

As a parent, I want to know that my children are getting all the goodness they need. Now, I can easily add essential minerals and vitamins to our daily diet.

Juicing cleanses, flushes, alkalizes and revitalizes the body. With its extra-large feeding tube and powerful motor, the Philips Juicer can turn any fruit or vegetable chopped or whole into juice instantly.

The Philips Way

Consumer Lifestyle

Today s empowered consumers are characterized by a desire for both wellness and pleasure. They want to enjoy a healthy life balance to look and feel good, and to benefit emotionally from rich, pleasurable technology experiences, both at home and on the move.

Through the application of design and deep consumer insight, we develop meaningful and innovative solutions that fulfill people s lifestyle needs and desires.

Total immersion

Philips Ambilight FlatTVs project a soft glow of light onto the walls around the TV set which automatically changes to match the colors and brightness of the picture, creating an immersive entertainment experience.

Safe to drink

The Philips Intelligent Water Purifier uses advanced UV technology and activated carbon to purify water, freeing consumers from the threat of water-borne diseases.

Entertainment on the go

Philips GoGear players can store thousands of MP3 music files, WMV videos and JPEG pictures, making it easy for consumers to enjoy their personal multimedia libraries while on the move.

One touch

Philips one-touch Espresso machine allows you to make a variety of coffee drinks at the push of a button.

Convenient communication

VoIP telephony has enabled millions of people to stay in touch via the Internet. Philips flagship DECT phone, the VOIP841, uniquely allows Skype calls from anywhere in the house without the need for a computer.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Realistic gaming

Philips amBX technology extends games beyond the screen, adding sensory experiences to gameplay through the use of light, color, sound, vibration and even air flow.

Fresh and confident

Philips Sonicare power toothbrushes with patented sonic technology and innovative brush-head design guarantee improved oral health and naturally whiter.

Music everywhere

Philips Streamium wireless music systems allow consumers to store their entire CD collections, and then stream that music throughout the home via WiFi.

A chore made easy

The Philips Wardrobe Care solution helps consumers keep their clothes looking like new with minimum effort.

Feels good

The Philips Moisturizing shaving system with integrated Nivea for Men shaving conditioner delivers an extra-comfortable shave that also conditions your skin.

Rest easy

Philips Avent DECT baby monitors are completely interference-free, offering excellent sound quality and total peace of mind.

Management discussion and analysis

Management discussion and analysis

Please refer to page 6 for more information about forward-looking statements, third-party market share data, fair value information, US GAAP basis of preparation, use of non-US GAAP information, statutory financial statements and management report, and reclassifications.

The analysis of the 2006 financial results compared to 2005, and the discussion of the critical accounting policies, have not been included in this Annual Report. These sections are included in Philips Form 20-F for the financial year 2007, which is filed electronically with the US Securities and Exchange Commission.

In 2007 we continued on the growth path we have been following in recent years redirecting resources to high-growth opportunities, making acquisitions, growing in emerging markets, leveraging our brand, and innovating and marketing for further organic growth.

98 Risk management | 112 Our leadership | 116 Report of the Supervisory Board | 126 Financial Statements

Management summary

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 EBITA 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 unless otherwise stated

		2005[1)]	2006[1)]	2007
Sales		25,445	26,682	26,793
EBITA		1,652	1,386	2,065
as a % of sales		6.5	5.2	7.7
EBIT		1,558	1,201	1,852
as a % of sales		6.1	4.5	6.9
Financial income and expenses		104	28	2,613
Income tax expense		(526)	(167)	(622)
Results of equity-accounted investees		1,754	(157)	763
Minority interests		(11)	(4)	(5)
Income from continuing operations		2,879	901	4,601
Income (loss) from discontinued operations		(11)	4,482	(433)
Net income		2,868	5,383	4,168
Per common share (in euro)	basic	2.29	4.58	3.84
Per common share (in euro)	diluted	2.29	4.55	3.80
Net operating capital (NOC)		5,439	8,518	10,586
Cash flows before financing activities		2,841	(2,472)	5,449
Employees (FTEs)		159,226	121,732	123,801
of which discontinued operations		44,174	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.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Management discussion and analysis

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.

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

The Group s EBITA 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 EBITA 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 EBITA 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	consolidation 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
I&EB	32.2	(4.5)	(80.6)	(52.9)
CMS	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.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

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, EBIT and EBITA according to the 2007 sector classification.

Philips Satinelle Ice is gentle for delicate skin and sensitive body areas thanks to a hypoallergenic ceramic epilating system and a detachable ice cooler.

Sales, EBIT and EBITA 2007

in millions of euros unless otherwise stated

	sales	EBIT	%	EBITA	%
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
I&EB	703	(101)	(14.4)	(83)	(11.8)
GMS	197	(297)		(297)	
Philips Group	26,793	1,852	6.9	2,065	7.7

Sales, EBIT and EBITA 2006[1)]

in millions of euros unless otherwise stated

	sales	EBIT	%	EBITA	%
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
I&EB	1,493	(94)	(6.3)	(76)	(5.1)
GMS	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

Management discussion and analysis

Philips, together with the Dutch oil company NAM, has developed a new type of lighting for offshore oil platforms, designed to reduce the number of birds being attracted and interrupting their migration across the North Sea (often with fatal consequences).

In 2007, EBIT 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, EBIT profitability improved by 1.4% in relation to sales, driven by the improved performance of DAP, Lighting and Group Management & Services.

Total EBITA 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 EBITA 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 EBITA 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% EBITA 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 EBITA 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% EBITA profitability, DAP s EBITA 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 EBITA 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 EBITA 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 EBITA in the other businesses, most notably Peripherals & Accessories and Entertainment Solutions.

Lighting s EBITA improved to EUR 722 million, or 11.9% of sales, mainly due to higher earnings in Lamps, Lumileds, Luminaires and additional EBITA 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 EBITA improvement.

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

Table of Contents

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

EBITA 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 EBITA 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.

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, EBIT included a net charge of EUR 37 million for restructuring.

Restructuring charges

in millions of euros

	2005[1)]	20061[1)]	2007
Restructuring:			
Medical Systems	2	14	1
DAP	4	13	1
Consumer Electronics	67	12	7
Lighting	35	48	28
I&EB	26		1
GMS			4
Reduction of excess provisions	(8)	(5)	(5)
	126	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.

Table of Contents

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

Management discussion and analysis

Financial income and expenses

A breakdown of the financial income and expenses is shown in the table below.

Financial income and expenses

in millions of euros

	2005[1)]	2006[1)]	2007
Interest expense (net)	(202)	(189)	(43)
Sale of securities	233		2,549
Other	73	217	107
	104	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.

Sale of securities

in millions of euros

	2005	2006	2007
Gain on sale of Atos Origin shares	185		
Gain on sale of Great Nordic shares	48		
Gain on sale TSMC shares			2,528
Loss on sale of JDS Uniphase			(10)
Gain on sale of Nuance			31
	233		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. For further information, please refer to note 6 of the notes to the Group financial statements.

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.

Results of equity-accounted investees

in millions of euros

	2005[1)]	2006[1)]	2007
Company s participation in income (loss)	513	(180)	271
Results on sale of shares	1,545	79	514
Gains arising from dilution effects	165	14	
Investment impairment and guarantee charges	(469)	(70)	(22)
	1,754	(157)	763

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

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

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 interests

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 2007, Philips and the German Heart Institute in Berlin (DHZB) opened the first fully integrated Philips Electrophysiology Lab. By creating a more intuitive working environment and integrating data management, workflow efficiency is greatly improved. Being able to determine the ambient environment of the lab puts patients at ease. The result better clinical focus and a friendlier environment for patients.

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.

Management discussion and analysis

The market launch of the first dual-branded products in September made the combined strengths of Philips and Avent clearly visible to our consumers.

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 EBIT 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.

Performance by market cluster

Philips monitors its performance on a geographical axis based on the following market clusters:

- key emerging markets, including China, India and Latin America
- other emerging markets, including emerging markets in Central and Eastern Europe, Russia, Ukraine and Central Asia, the Middle East and Africa, Turkey and the ASEAN zone
- mature markets, including Western Europe, North America, Japan, Korea, Australia and New Zealand.

In 2007, sales growth was particularly strong in emerging markets, which will continue to be a focal area of growth for Philips. Emerging markets, most notably China, Russia and India, contributed 60% to our comparable sales increase in value, while accounting for approximately one third of total revenues.

Key emerging markets showed strong comparable growth, primarily driven by Lighting, Medical Systems and DAP, partly offset by a sales decline at CE, mainly due to Connected Displays in Latin America.

Other emerging markets delivered strong double-digit sales growth compared to 2006, driven by the outstanding performance of DAP and CE as well as robust expansion of Lighting and Medical Systems in these countries.

Sales in Western Europe showed a solid increase on a comparable basis, visible in all sectors, most notably the double-digit increase at DAP, followed by good performances by CE, Lighting and Medical Systems.

In North America, sales on a comparable basis remained stable compared to 2006. A strong performance by DAP, driven by the successful introduction of new shaving and oral healthcare products, and moderate growth at Medical Systems, despite a decline at Imaging Systems, were largely offset by lower comparable sales at CE, predominantly attributable to strong competition and price pressure in Flat TV.

EBITA in mature markets in Europe increased by EUR 328 million, driven by DAP, CE and Lighting. The EBITA improvement in North America was largely due to the EUR 256 million product liability charge in 2006. Key emerging markets generated EBITA of EUR 209 million, a EUR 84 million improvement compared to 2006, mainly driven by significantly higher EBITA at DAP and Lighting. EBITA declined in other emerging markets, largely due to CE.

EBITA per market cluster
in millions of euros

	2005[1)]	2006[1)]	2007
Western Europe	1,036	953	1,281
North America	296	23	315
Other mature markets	37	32	41
Total mature markets	1,369	1,008	1,637
Key emerging markets	79	125	209
Other emerging markets	204	253	219
	1,652	1,386	2,065

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

EBIT per market cluster
in millions of euros

	2005[1)]	2006[1)]	2007
Western Europe	1,034	944	1,215
North America	206	(151)	171
Other mature markets	37	32	41
Total mature markets	1,277	825	1,427
Key emerging markets	77	123	206
Other emerging markets	204	253	219
	1,558	1,201	1,852

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

Marketing

Philips continues to increase its focus on insight-driven innovation to fuel growth. 2007 saw improvements in our ability to understand user needs and to translate these insights into compelling solutions. The increase in quality of our user insights is evidenced by the top-tier performance against industry benchmark of more than half our end-user insight projects, an improvement of 20% compared to 2006.

Key products and solutions launched in 2007 such as HeartStart MRx, Arcitec, Aurea and AmbiScene, are examples of products based on compelling user insights in Medical Systems, DAP, CE and Lighting respectively. Our progress in insight-driven innovation enables us to develop solutions which are truly differentiating in the perception of people using them. This puts us in a better position to maintain premium price levels and therefore to drive sustainable profitable growth.

In 2007, total Philips marketing expenditures amounted to EUR 994 million, or 3.7% of sales, compared to 3.3 % of sales in 2006. The spend increases in advertising and promotion our largest spend categories were partly offset by efficiency gains realized in cost of infrastructure. In addition, we invested more in marketing intelligence to strengthen our understanding of end-user and customer insights.

In 2007, we continued to invest in building the Philips brand, supported by a EUR 111 million investment in the global brand campaign. These efforts resulted in a substantial year-on-year increase in our brand value, as reported by Interbrand, rising from USD 6.7 billion in 2006 to USD 7.7 billion in 2007. The Philips brand was ranked the 42nd most valuable global brand in 2007, up from 48th in 2006, according to Interbrand.

The 2007 development was primarily driven by increased appreciation of our Medical Systems business, which currently has the highest brand value within the Group. The Interbrand analysis showed that 35% of sales decisions in the healthcare sector are made based on brand. This demonstrates the importance of a strong brand for driving sales in the business-to-business as well as the business-to-consumer environment. The Philips brand is strongly positioned to do so.

Research and development

Strong performance in innovation is critical for Philips to increase its market competitiveness. Through substantial investments in research & development (R&D), Philips has created a vast knowledge base. In direct response to the needs of the market, Philips has adopted a more end-user-oriented approach to innovation in recent years, in order to balance investments between projects with more apparent short-term commercial prospects and projects creating new options for medium and long-term value-creation.

Philips R&D activities are shared across Corporate Technologies and the operating divisions. The Chief Technology Officer (CTO) of Philips manages the enabling technologies across the Company.

Corporate Technologies, employing 2,800 people, invests in world-class competencies and technologies that are relevant to the entire Philips Group. In the operating divisions, some 7,800 employees in 26 countries are predominantly engaged in the development of products and applications.

Technology, competence and innovation management

The CTO office is focused on technology management, competence management and innovation effectiveness across Philips. Competence management in R&D is supported by a company-wide R&D core curriculum. The CTO office also runs the Innovation Excellence program, a cross-functional drive towards a market-driven alignment of all Philips-wide innovation processes.

Table of Contents

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

In 2007, Philips invested EUR 1.6 billion, or 6.1% of sales, in research and development, slightly less than in 2006. Higher investments in Medical Systems, Lighting, DAP and Innovation & Emerging Businesses were more than offset by lower expenditures in CE, largely due to the divestment of Mobile Phones.

Research and development expenditures per sector [2)3)]

in millions of euros

	2005[1)]	2006[1)]	2007
Medical Systems	517	566	584
DAP	139	168	171
Consumer Electronics	419	385	311
Lighting	212	269	282
I&EB	587	577	598
Inter-sector eliminations	(281)	(306)	(317)
Philips Group	1,593	1,659	1,629

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

2) Includes the write-off of acquired in-process research and development of EUR 13 million in 2007 (2006: EUR 33 million, 2005: EUR 6 million)

3) Total R&D expenditures include costs related to external contract research, accounting for 2%, 3% and 5% of the Company s R&D expenditures for the years 2005, 2006 and 2007,

respectively.

Medical Systems increase in R&D investment was primarily related to the acquisition of Intermagnetics at the end of 2006. DAP s expenditures on research and development were on par with 2006, including investments in the new Arcitec shaver and the FlexCare toothbrush, both launched in the second half of 2007. CE reduced its R&D expenditures, primarily due to the divestment of the Mobile Phones business. Lighting s research and development costs increased slightly compared to 2006, primarily due to acquisitions. Research and development expenditures at Innovation & Emerging Businesses increased year-on-year, primarily due to higher R&D investments in the Healthcare and Lifestyle Incubators within Corporate Technologies.

In 2007, investments in innovative technologies increased, especially in energy-efficient and solid-state lighting solutions as well as in the areas of healthcare and wellness.

Philips strong innovation pipeline contributed significantly to the Company s sales growth in 2007, as 56% of Group sales came from newly introduced products, mainly driven by above-average contributions from CE and Medical Systems. Philips aims to maintain its new-product-to-sales ratio above 50%, while at the same time focusing on the profitability of new products.

At the Izmir Sirinyer Hippodrome in Turkey, a new lighting installation featuring state-of-the-art Philips ArenaVision floodlights has been commissioned to allow night-time racing for the very first time.

Management discussion and analysis

Opening at Schiphol Airport, Amsterdam, in early 2008, the first implementation of Philips One Star is Born concept by hotel chain citizenM has been developed to offer guests affordable luxury . Integrating multiple functionalities, this innovative solution puts the consumer at the heart of the hotel experience and enables hotel owners to optimize operating costs.

Employment

Employment

in FTEs

	2005	2006	2007
Position at beginning of year	161,586	159,226	121,732
Consolidation changes:			
- new consolidations	1,795	4,834	6,654
- deconsolidations	(2,552)	(44,085)	(3,535)
Comparable change	(1,603)	1,757	(1,050)
Position at year-end	159,226	121,732	123,801
of which:			
continuing operations	115,052	115,092	118,098
discontinued operations	44,174	6,640	5,703

Excluding discontinued operations (MedQuist in 2007 and Semiconductors in 2006), the total number of employees of the Philips Group was 118,098 at the end of 2007, compared to 115,092 at the end of 2006. Approximately 46% were employed in the Lighting sector, due to the strong vertical integration of this business, and about 23% at Medical Systems. The consumer businesses DAP and CE accounted for 20% of Philips workforce.

The main employee increase in 2007 came from acquisitions made in Lighting (Partners in Lighting International, Color Kinetics), CE (Digital Lifestyle Outfitters) and in Innovation & Emerging Businesses (Health Watch and Raytel Cardiac Services).

The largest reductions in 2007 occurred due to the sale of business interests in Innovation & Emerging Businesses (most notably Optical Storage), in CE (primarily the Mobile Phones business) and in Group Management & Services (principally the Financial Shared Services operations).

Employees per sector
in FTEs at year-end

	2005	2006	2007
Medical Systems	24,221	26,203	27,441
DAP	8,203	9,933	9,881
Consumer Electronics	15,537	14,486	13,516
Lighting	45,649	47,739	54,323
I&EB	15,130	9,852	7,638
CMS	6,312	6,879	5,299
	115,052	115,092	118,098
Discontinued operations	44,174	6,640	5,703
	159,226	121,732	123,801

Some 60% of Philips workforce is located in mature markets, and some 40% in emerging markets. In 2007, key emerging markets saw a nominal employee decline compared to 2006, largely due to the sale of the Financial Shared Services operations in India and the divestment of Mobile Phones within CE. The sale of the Financial Shared Services operations in Poland and Thailand was the main reason for the employee decline in other emerging markets. In mature markets in Europe, the number of employees increased, mainly due to the acquisition of Belgium-based PLI. North America saw an increase in employees mainly related to the acquisitions of Color Kinetics, DLO, Health Watch and Raytel Cardiac Services.

Employees per market cluster
in FTEs at year-end

	2005	2006	2007
Western Europe	42,226	38,852	46,466
North America	17,455	20,501	21,682
Other mature markets	1,900	1,831	1,850
Total mature markets	61,581	61,184	69,998
Key emerging markets	32,469	31,893	30,323
Other emerging markets	21,002	22,015	17,777
	115,052	115,092	118,098
Discontinued operations	44,174	6,640	5,703
	159,226	121,732	123,801

Sales per employee decreased by 2% from EUR 228,000 in 2006 to EUR 224,000 in 2007, affected by 4% unfavorable currency movements compared to 2006.

Adjusted for the adverse foreign currency impact in 2007, average sales per employee increased by 2%. This rise was driven by the significantly improved performance in CE, DAP and Lighting, partly offset by declines in Medical Systems, primarily due to the further vertical integration related to the acquisition of Intermagnetics, and in Innovation & Emerging Businesses, related to the divestment of Optical Storage.

Liquidity and capital resources

Liquidity and capital resources

Cash flows provided by continuing operations

Condensed consolidated statements of cash flows for the years ended December 31, 2005, 2006 and 2007 are presented below:

Condensed consolidated cash flow statements

in millions of euros

	2005[1)]	2006[1)]	2007
Cash flows from operating activities:			
Net income	2,868	5,383	4,168
(Income) loss from discontinued operations	11	(4,482)	433
Adjustments to reconcile net income to net cash provided by operating activities	(1,732)	(571)	(3,082)
Net cash provided by operating activities	1,147	330	1,519
Net cash provided by (used for) investing activities	1,694	(2,802)	3,930
Cash flows before financing activities	2,841	(2,472)	5,449
Net cash used for financing activities	(2,589)	(3,715)	(2,368)
Cash provided by (used for) continuing operations	252	(6,187)	3,081
Net cash provided by (used for) discontinued operations	533	7,114	(115)
Effect of changes in exchange rates on cash positions	159	(197)	(112)
Total change in cash and cash equivalents	944	730	2,854
Cash and cash equivalents at beginning of year	4,349	5,293	6,023
Less cash and cash equivalents at end of year - discontinued operations	150	137	108
Cash and cash equivalents at end of year - continuing operations	5,143	5,886	8,769

1) Restated to present the MedQuist business as a discontinued operation. Please refer to the consolidated statements of cash flows which are part of the chapter Group financial statements.

Net cash from operating activities amounted to EUR 1,519 million in 2007, compared to cash flows of EUR 330 million in 2006. This EUR 1,189 million increase was driven by higher cash generation at DAP, CE and GMS, due to increased earnings and lower working capital requirements. In addition, the improvement was related to a EUR 742 million reduction in pension contributions compared to 2006, which positively affected working capital.

Net capital expenditures totaled EUR 698 million, broadly in line with 2006. Reduced expenditures in Lighting mainly related to higher investments in the acquired Lumileds business in 2006 and DAP were partly offset by higher investments at Medical Systems and CE. Proceeds from the sale of fixed assets were lower than in 2006.

The EUR 4,105 million proceeds from the sale of other non-current financial assets were primarily related to the further reduction of our financial holding in TSMC, which yielded EUR 3,895 million.

Additionally, EUR 1,640 million cash was generated from the sale of interests in businesses, including the sale of 46.4 million shares in LG. Philips LCD, resulting in a cash inflow of EUR 1,547 million, as well as the divestments of the remaining parts of Optical Storage and Mobile Phones. Furthermore, a net amount of EUR 385 million cash was generated from maturing currency hedges.

During 2007, a total of EUR 1,502 million was utilized for acquisitions, notably PLI (EUR 561 million) and Color Kinetics (EUR 515 million), as well as DLO, Health Watch and Raytel Cardiac Services.

In 2006, a total of EUR 2,498 million was used for acquisitions, notably Intermagnetics (EUR 993 million), Avent (EUR 689 million), Lifeline (EUR 583 million) and Witt Biomedical (EUR 110 million). The divestment of businesses, primarily within Innovation & Emerging Businesses, generated EUR 384 million cash.

Cash flow from discontinued operations

In 2007, EUR 115 million cash was used by discontinued operations, the majority of which related to tax payments in connection with the 2006 sale of Philips majority stake in the Semiconductors business and operating cash flows of MedQuist in 2007.

In 2006, discontinued operations generated cash flows of EUR 7,114 million, predominantly related to the sale of a majority stake in the Semiconductors division, which generated EUR 7,059 million.

Cash flows from financing activities

Net cash used for financing activities in 2007 was EUR 2,368 million. The impact of changes in debt was a reduction of EUR 281 million, including a EUR 113 million repayment of long-term bank borrowings. Philips shareholders were paid EUR 659 million in dividend. Additionally, cash outflows for share repurchase totaled EUR 1,609 million. This included EUR 810 million related to hedging of obligations under the long-term employee incentive and employee stock purchase programs, and a total of EUR 823 million related to the repurchases of the shares for cancellation, offset by EUR 24 million representing dividend tax credit facility. Partially offsetting these cash outflows was a net cash inflow of EUR 161 million due to the exercise of stock options.

Net cash used for financing activities in 2006 was EUR 3,715 million. The impact of changes in debt was a reduction of EUR 437 million, including a EUR 208 million scheduled bond repayment Philips shareholders were paid EUR 523 million in dividend. Additionally, cash outflows for share repurchase totaled EUR 2,899 million. This included EUR 414 million final repurchases related to the EUR 1.5 billion share repurchase program announced in August 2005 that was completed in February 2006, a total of EUR 118 million related to

Liquidity and capital resources

hedging of obligations under the long-term employee incentive and employee stock purchase programs, and a total of EUR 2,367 million of share repurchases for cancellation between July and December 2006. Offsetting the cash outflows in part was a net cash inflow of EUR 145 million due to the exercise of stock options.

Financing

The consolidated balance sheet for the years 2007,2006 and 2005 is presented below:

Condensed consolidated balance sheet

in millions of euros

	2005[1)]	2006[1)]	2007
Cash and cash equivalents	5,143	5,886	8,769
Receivables	8,874	9,651	9,500
Assets of discontinued operations	4,484	431	333
Inventories	2,797	2,880	3,203
Equity-accounted investees	5,338	2,974	1,886
Other non-current financial assets	729	8,055	3,183
Property, plant and equipment	2,999	3,084	3,180
Intangible assets	3,541	5,536	6,289
Total assets	33,905	38,497	36,343
Accounts payable and other liabilities	8,433	8,129	7,799
Liabilities of discontinued operations	1,627	169	157
Provisions	2,634	3,293	3,104
Debt	4,487	3,869	3,557
Minority interests	58	40	42
Stockholders equity	16,666	22,997	21,684
Total liabilities and equity	33,905	38,497	36,343

1) Restated to present the MedQuist business as a discontinued operation. Please refer to the consolidated balance sheets which are part of the chapter Group financial statements.

Cash and cash equivalents

In 2007, cash and cash equivalents from continuing operations increased by EUR 2,883 million to EUR 8,769 million at year-end. Cash proceeds from divestments amounted to EUR 5,745 million, including a net cash inflow of EUR 3,895 million as a result of the sale of shares in TSMC and EUR 1,547 million for LG. Philips LCD. The share

buyback programs led to a cash outflow of EUR 1,609 million. There were further cash outflows for acquisitions of EUR 1,502 million, including EUR 561 million for Partners in Lighting International, EUR 515 million for the acquisition of Color Kinetics, EUR 94 million for Health Watch, EUR 55 million for TIR Systems, EUR 77 million for Digital Lifestyle Outfitters and EUR 74 million for Raytel Cardiac Services. Furthermore, a dividend of EUR 659 million was paid. Currency changes during 2007 decreased cash and cash equivalents by EUR 112 million.

In 2006, cash and cash equivalents from continuing operations increased by EUR 743 million to EUR 5,886 million at year-end.

Cash proceeds from divestments amounted to EUR 7,218 million, including a net cash inflow of EUR 7,059 million as a result of the sale of a majority stake in the Semiconductors division. The share buyback programs led to a cash outflow of EUR 2,899 million. There were further cash outflows for acquisitions of EUR 2,498 million, including EUR 583 million for the acquisition of Lifeline, EUR 689 million for Avent, EUR 993 million for Intermagnetics and EUR 110 million for Witt Biomedical. Furthermore, a dividend of EUR 523 million was paid. Currency changes during 2006 decreased cash and cash equivalents by EUR 197 million.

Debt position

Total debt outstanding at the end of 2007 was EUR 3,557 million, compared with EUR 3,869 million at the end of 2006.

Changes in debt

in millions of euros

	2005[1)]	2006[1)]	2007
New borrowings	74	106	29
Repayments	(398)	(543)	(310)
Consolidation and currency effects	298	(181)	(31)
Total changes in debt	(26)	(618)	(312)

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

During the year, total debt decreased by EUR 312 million. Philips repaid EUR 113 million of bank facilities; repayments under capital leases were EUR 24 million and EUR 15 million resulted from reductions in other long-term debt. Repayments under short-term debt totaled EUR 158 million. New borrowings totaled EUR 29 million. Other changes resulting from consolidation and currency effects led to a reduction of EUR 31 million.

In 2006, total debt decreased by EUR 618 million. Philips repaid EUR 208 million in a scheduled bond repayment. The remaining repayments consisted of bank facilities of EUR 277 million, capital lease transactions of EUR 8 million and EUR 50 million resulting from reductions in other debt. New borrowings of EUR 106 million included EUR 97 million from increased short-term borrowings.

Other changes resulting from consolidation and currency effects led to a reduction of EUR 181 million.

Long-term debt as a proportion of the total debt stood at 34% at the end of 2007, compared to 78% at the end of 2006.

Net debt to group equity

The Company had a net cash position (cash and cash equivalents, net of debt) of EUR 5,212 million at the end of 2007, compared to a net cash position at the end of 2006 of EUR 2,017 million.

Stockholders equity

Stockholders equity decreased by EUR 1,313 million to EUR 21,684 million at December 31,2007. The decrease was mainly attributable to share repurchase programs for both capital reduction purposes and the hedging of long-term incentive and employee stock purchase programs, which reduced equity by a total of EUR 1,633 million. The dividend payment to shareholders in 2007 further reduced equity by EUR 659 million. The decrease was offset by EUR 305 million related to re-issuance of treasury stock and share-based compensation plans and a further EUR 674 million increase related to total changes in comprehensive income net of tax.

Stockholders equity increased by EUR 6,331 million to EUR 22,997 million at December 31,2006. Net income contributed EUR 5,383 million, while unrealized gains on available-for-sale securities had an upward effect of EUR 4,291 million, mainly related to the changed accounting treatment of TSMC. The unrealized gain on the value of TSMC was partly offset by EUR 2,899 million due to the share repurchase programs for both capital reduction purposes and the hedging of long-term incentive and employee stock purchase programs, and by EUR 523 million due to the dividend payment to shareholders in 2006. There was a net decrease of EUR 263 million related to pension liabilities, including the effect of adoption of SFAS No. 158.

The number of outstanding common shares of Royal Philips Electronics at December 31, 2007, was 1,065 million (2006:1, 107 million).

At the end of 2007, the Company held 52.1 million shares in treasury to cover the future delivery of shares in connection with the 61.4 million rights outstanding at year-end 2007 under the Company s long-term incentive plan and convertible personnel debentures. At the end of 2007, the Company held 25.8 million shares for cancellation. At the end of 2006, the Company held 35.9 million shares in treasury to cover the future delivery of shares in connection with the 65.5 million rights outstanding at year-end 2006 under the Company s long-term incentive plans and convertible personnel debentures. Treasury shares are accounted for as a reduction of stockholders equity.

Liquidity position

Including the Company s net cash position, listed available for-sale securities, trading securities and listed equity-accounted investees, as well as its USD 2.5 billion commercial paper program supported by the revolving credit facility, the Company had access to net available liquidity resources of EUR 11,374 million as of December 31, 2007, compared to EUR 13,439 million one year earlier.

Table of Contents

Liquidity and capital resources

Liquidity position
in millions of euros

	2005[2]	2006[2]	2007
Cash and cash equivalents	5,143	5,886	8,769
Long-term debt	(3,320)	(3,006)	(1,212)
Short-term debt	(1,167)	(863)	(2,345)
Net cash	656	2,017	5,212
Available-for-sale securities at market value	113	6,529	1,776
Trading securities		192	
Main listed investments in equity-accounted investees at market value	11,139	2,803	2,688
Net available liquidity	11,908	11,541	9,676
Revolving credit facility / CP program[1]	2,109	1,898	1,698
Net available liquidity resources	14,017	13,439	11,374

1) The revolving credit facility could act as a back-up for the CP program

2) Restated to present the MedQuist business as a discontinued operation

The fair value of the Company s listed available-for-sale securities, based on quoted market prices at December 31, 2007, amounted to EUR 1,776 million, of which EUR 1,699 million related to TSMC. Philips shareholdings in its main listed equity-accounted investees had a fair value of EUR 2,688 million based on quoted market prices at December 31, 2007, and consisted primarily of the Company s holdings in LG.Philips LCD with a value of EUR 2,556 million and TPV Technology with a value of EUR 130 million. The Company has a lock-up period associated with the sale of shares in TPV that expires in September 2008 and LG.Philips LCD that expired in January 2008.

Philips has a USD 2.5 billion commercial paper program, under which it can issue commercial paper up to 364 days in tenor, both in the US and in Europe, in any major freely convertible currency. There is a panel of banks, six in Europe and five in the US, that support the program. When Philips wants to fund through the commercial paper program, it contacts the panel of banks. The interest is at market rates prevailing at the time of issuance of the commercial paper. There is no collateral requirement in the commercial paper program. There are no limitations on Philips use of the program, save for market considerations, e.g. that the commercial paper market itself is not open. If this were to be the case, Philips USD 2.5 billion committed revolving credit facility could act as back-up for short-term financing requirements that normally would be satisfied through the commercial paper program. The USD 2.5 billion revolving credit facility does not have a material adverse change clause, has no financial covenants and does not have credit-rating-related acceleration possibilities. As of December 31, 2007, Philips did not have any commercial paper outstanding.

As at December 31, 2007, the Company had total cash and cash equivalents of EUR 8,769 million; the Company pools cash from subsidiaries in the extent legally and economically feasible. Cash in subsidiaries is not necessarily freely available for alternative uses due to possible legal or economic restrictions. The amount of cash not immediately available is not considered material for the Company to meet its cash obligations. The Company had a total debt position of EUR 3,557 million at year-end 2007.

The Company expects to have significant cash outflows during 2008 that will affect the overall liquidity position of the Company. In November 2007, the Company announced the aquisition of Genlyte Group Incorporated for an expected purchase price of EUR 1.8 billion. This acquisition was completed in January 2008. During December 2007 the Company announced further acquisitions including Respironics for an expected purchase price of EUR 3.6 billion and VISICU for EUR 290 million. The Company has also announced its intention to repurchase a further EUR 5 billion of shares for cancellation, and this program is largely expected to be completed during 2008. Also included within total short-term debt is EUR 1,692 million of bonds, with EUR 130 million due to mature in February 2008 and EUR 1,562 million due to mature in May 2008. The dividend for 2008 is expected to be some EUR 715 million.

Guarantees and contractual cash obligations

Guarantees

Guarantees issued or modified after December 31,2003, having characteristics defined in FASB Interpretation No. 45 Guarantor s Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others (FIN 45), are measured at fair value and recognized on the balance sheet. At the end of 2007, the total fair value of guarantees recognized by the Company was EUR 3 million.

Guarantees issued before December 31, 2003, and not modified afterwards, and guarantees issued after December 31, 2003, which do not have characteristics defined in FIN 45, remain off-balance sheet.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Philips policy is to provide only guarantees and other letters of support, in writing. Philips does not stand by other forms of support. The following table outlines the total outstanding off-balance sheet credit-related guarantees and business-related guarantees provided by Philips for the benefit of unconsolidated companies and third parties as at December 31,2007.

Expiration per period 2007
in millions of euros

	total amounts committed	less than 1 year	1-5 years	after 5 years
Business-related guarantees	432	142	95	195
Credit-related guarantees	45	5	16	24
	477	147	111	219

Expiration per period 2006
in millions of euros

	total amounts committed	less than 1 year	1-5 years	after 5 years
Business-related guarantees	466	151	80	235
Credit-related guarantees	42	14	2	26
	508	165	82	261

Contractual cash obligations

Presented below is a summary of the Group s contractual cash obligations, contingent obligations resulting from guarantees provided, and the capital resources available to fund the cash requirements.

Cash obligations at December 31,2007 [2)]
in millions of euros

				payments due by period	
	total	less than 1 year	1-3 years	3-5 years	after 5 years
Long-term debt[1)]	2,973	1,841	19	754	359
Capital lease obligations[1)]	88	8	15	8	57
Short-term debt[1)]	496	496			
Operating leases[1)]	730	147	232	134	217
Bond interest	655	171	143	97	244
	4,942	2,663	409	993	877

1) Short-term debt long-term debt and capital lease obligations are included in the Company s consolidated

balance sheet; please refer to note 23, note 24 and note 26 of the notes to the group financial statements

2) For further details about uncertain tax positions, amounting to EUR 627 million, see note 6 of the notes to the Group financial statements

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

Based on past operating performance and current prospects, supported by the Company s balance sheet and unused borrowing capacity, Philips believes that working capital is sufficient for the Company s present requirements. Furthermore, the Company has no material commitments for capital expenditures.

The Company had total amounts payable in relation to accrued interest on debt of EUR 110 million as at December 31,2007.

The Company sponsors pension plans in many countries in accordance with legal requirements, customs and the local situation in the countries involved. The majority of employees in Europe and North America are covered by defined-benefit plans.

Contributions to funded pension plans are made by the Company, as necessary, to provide sufficient assets to meet future benefits payable to plan participants. These contributions are determined by various factors, including funded status, legal and tax considerations and local customs.

The Company currently expects cash outflows in relation to employee benefits which are estimated to amount to EUR 314 million in 2008 (2007: EUR 433 million), consisting of EUR 160 million employer contributions to defined-benefit pension plans, EUR 89 million employer contributions to defined-contribution pension plans, and EUR 65 million expected cash outflows in relation to unfunded pension plans.

The expected cash outflows in 2008 and subsequent years are uncertain and may change substantially as a consequence of statutory funding requirements as well as changes in actual versus currently assumed discount rates, estimations of compensation increases and returns on pension plan assets.

for further details about cash obligations related to pension plans, see note 20 of the group financial statements.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Acquisitions

Acquisitions

In the course of 2007 we completed ten strategically aligned acquisitions and announced three more acquisitions that are expected to be, or have been, completed in the first quarter of 2008. At the same time, we divested a number of non-core activities and reduced our shareholdings in cyclical businesses in a responsible manner

The Color Kinetics-illuminated London Eye is the world s largest observation wheel at nearly 135 metres high. A new LED-based lighting system brings dynamic, visually appealing color to the structure while at the same time alleviating the maintenance costs
and requirements of the previous fluorescent system.

Medical Systems

VMI-Sistemas Medicos

In professional healthcare, Philips acquired Brazil s leading general X-ray manufacturer, VMI-Sistemas Medicos.

XIMIS

Philips also acquired US-based healthcare IT company XIMIS, which focuses on systems to help reduce errors and streamline workflow in hospital radiology wards.

Emergin

Philips acquired Emergin, the leading US provider of software utilized to rapidly transmit medical alarm signals throughout hospitals. Through this acquisition, Philips will expand the use of information technology in healthcare and specifically in its patient monitoring business to improve patient outcomes and help hospitals work more efficiently.

VISICU

In December 2007, Philips announced a merger agreement with clinical IT and service provider VISICU. Based in Baltimore, USA, VISICU makes clinical IT systems that enable critical-care medical staff to actively monitor patients in hospital intensive care units (ICUs) from remote locations. VISICU s patented clinical IT system, called the eICU program, provides real-time 24/7 patient monitoring in ICUs by centrally networking critical-care physicians and nurses to ICU beds using voice and video. Equipped with artificial intelligence algorithms, the system also offers advanced clinical support. The merger will boost the creation of products to give more clinical decision support to hospital staff, while allowing them to monitor greater numbers of critically ill patients.

Consumer Electronics

Digital Lifestyle Outfitters

In the fast-growing, high-margin area of electronics peripherals and accessories, Philips acquired US-based Digital Lifestyle Outfitters, which designs, markets and distributes accessories for mobile audio-visual devices such as MP3 and video players. Through this deal, Philips has bolstered its position as a leading player in peripherals and accessories for the mobility domain, further strengthening its contacts with key international retailers.

Lighting

Color Kinetics

In the professional lighting sector, Philips acquired Color Kinetics (EUR 515 million), based in Boston, USA. Color Kinetics is a leader in the design and marketing of innovative light-emitting diode (LED) lighting systems.

TIR Systems

We also completed the acquisition of Vancouver, Canada-based TIR Systems, a leading company in LED technology for modules that generate high-quality white light.

The acquisitions of Color Kinetics and TIR Systems will give Philips a leading position in the entire LED lighting value chain, bolstering its strong LED intellectual property portfolio and further adding to this fast-growing new segment. Philips is increasingly benefiting from its leadership position in the shift to energy-efficient lighting solutions, both in the professional and consumer domains.

Partners in Lighting International

In the consumer lighting sector, Philips completed its acquisition of Partners in Lighting International (PLI) (EUR 561 million), the leading European manufacturer of home luminaires. PLI develops, manufactures and markets a wide portfolio of more than 10,000 distinct home lighting luminaire products, currently mainly for the

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Acquisitions

Building upon our 2006 purchase of Lifeline, in 2007 we announced a number of strategically aligned acquisitions Respironics, Health Watch and Raytel Cardiac Services designed to further strengthen our position in the fast-growing home healthcare solutions market.

European market. This acquisition will strengthen Philips presence in LEDs especially for home lighting, where solid-state lighting (SSL) will bring major benefits in terms of creating atmospheres and reducing energy consumption.

Lighting Technologies International

In November 2007, Philips acquired Lighting Technologies International (LTI), a US-based manufacturer of high-power xenon lamps for the entertainment industry and a leading supplier of cinema projection lighting in the United States. LTI s strong presence in applications for high-power xenon lamps will round off Philips portfolio of xenon lamps.

Genlyte

In January 2008, Philips completed the acquisition of North American luminaires company Genlyte, a leader in the North American construction luminaires market, for EUR 1.8 billion. Genlyte designs, manufactures and sells lighting fixtures, controls and related products for a wide variety of applications, including solid-state lighting. This acquisition builds on our earlier acquisitions of Color Kinetics, TIR Systems, Partners in Lighting International and provides us with a leading position in the North American luminaires market. Through this acquisition, Philips has established a solid platform for further profitable growth, building on Genlyte s extensive presence in North America to speed up the adoption of energy-saving, green lighting technologies.

Consumer Healthcare Solutions

Unsustainably high healthcare costs in many markets, the aging of the population and the expectation that seniors will double as a percentage of the total population over the next 25 years in Western Europe and the US, are factors underpinning Philips drive to become a global player in the home healthcare market.

Health Watch

In 2007, Philips acquired personal emergency response company Health Watch, a US-based, privately-held provider of personal emergency response services. This acquisition will further strengthen our leadership position in the fast-growing market for emergency response services, building on the Lifeline Systems acquisition in 2006.

The inclusion of Health Watch increases the number of healthcare organizations and healthcare referral sources in the Philips Lifeline network, further contributing to future growth.

Raytel Cardiac Services

Philips also acquired US-based Raytel Cardiac Services, a leading US provider of home cardiac monitoring services that doctors prescribe to heart patients. Acquiring Raytel Cardiac Services represents a further step in our healthcare strategy of improving patient outcomes in specific care cycles, such as cardiology, and builds on our leading position in medical technologies for heart disease (the most common cause of death in the developed world). Philips has invested heavily over the years to become the top supplier to hospitals of medical equipment for managing heart disease.

Respironics

In December 2007, Philips announced the projected acquisition of Respironics for EUR 3.6 billion, which would be its biggest-ever acquisition. Respironics is a global leader in the treatment of Obstructive Sleep Apnea (OSA), a sleep disorder characterized by the repeated cessation of breathing during sleep. Research in recent years has shown a link between OSA, heart disease, stroke and diabetes. Additionally, Respironics has a leading position in non-invasive ventilation and has recently introduced new home oxygen technologies to serve the needs of respiratory-impaired patients in the home. The remainder of Respironics business is focused on the hospital channel and includes non-invasive and invasive ventilation, respiratory monitoring, neonatal products and respiratory drug delivery technologies for the treatment of respiratory diseases. The deal adds new product categories in OSA and home respiratory care to our existing businesses in this field. Respironics fits well into Philips strategy to become the world leader in the fast-growing home healthcare market.

Divestments

In the course of 2007, we sold, or decided to sell, several of our non-core business interests. Also, we continued to reduce our financial holdings in cyclical businesses.

On March 31, 2007, the Company completed the sale of its remaining Mobile Phones activities to China Electronics Corporation (CEC). CEC has received an exclusive license to market and sell mobile phones under the Philips brand for the coming five years.

On November 2, 2007, Philips announced that a decision has been made to proceed with the sale of its approximate 70% ownership interest in MedQuist, as the Company considers its MedQuist ownership interest as a non-core holding.

On December 19, 2007, Philips announced it has reached an agreement in principle to sell its Set-Top Boxes and Connectivity Solutions activities, currently part of its Home Networks business unit within Consumer Electronics, to Pace Micro Technology. After completion, Philips will become shareholder of some 23% in the combined business. The transaction is expected to close at February 20, 2008.

As part of a multi-phase plan to facilitate an orderly exit from the Company s shareholding in Taiwan Semiconductor Manufacturing Company, Philips sold 2.8 billion common shares in TSMC in the course of 2007. This plan, announced on March 9, 2007, aims to reduce Philips holding in TSMC to zero before the end of 2010.

In line with Philips strategy to further reduce its holding in LG.Philips LCD in a structured and responsible manner, the Company sold 46.4 million shares of common stock in LG.Philips LCD, thereby reducing its shareholding to 19.9%. The transaction provided Philips with net proceeds of EUR 1.5 billion.

Other information

Other information

Share repurchase programs

On January 22, 2007, the Company started a EUR 1.6 billion share repurchase program for capital reduction purposes through a second trading line on Euronext Amsterdam. Under this program, shares are repurchased from shareholders who are tax-exempt or are able to achieve tax compensation. Under this program, a total of 25,813,898 shares were acquired worth EUR 0.8 billion. The mechanics of the second trading line and all transactions in Philips shares under this share repurchase program are published on the Company s website.

On September 5, 2007, the Company started a program to repurchase approximately 15 million additional Philips shares on Euronext Amsterdam in connection with cumulative obligations resulting from its existing long-term incentive and employee stock purchase programs. These repurchases were completed in 2007 and increased the number of shares held by the Company versus shares due under the programs. The shares repurchased are held by the Company as treasury shares until they are required.

On December 19, 2007, the Company announced that it plans to repurchase up to approximately EUR 5 billion worth of Philips shares for the purpose of capital reduction, which program is expected to be largely completed by the end of 2008. This program includes the portion of the Company s EUR 1.6 billion second trading line repurchase program that has yet to be completed. Through its second trading line program, Philips repurchased EUR 0.8 billion worth of shares for cancellation in 2007. The Company started the new repurchase program on January 2, 2008, and will enter into subsequent discretionary management agreements with one or more banks to repurchase Philips shares within the limits of relevant laws and regulations (in particular EC Regulation 2273/2003) and Philips articles of association. The appropriate authorizations to complete the program will be proposed to the 2008 Annual General Meeting of Shareholders.

In accordance with Dutch law, the Company has informed the Netherlands Authority for the Financial Markets of its holdings of Philips shares. All transactions in Philips shares under these share repurchase programs have been and will be reported on the Company s website on a weekly basis.

Capital reduction

On January 18, 2008, the Company started the procedure for the cancellation of Philips shares acquired or to be acquired pursuant to the share repurchase programs for capital reduction purposes initiated in January 2007 and January 2008. The number of shares to be cancelled shall be determined by the Board of Management but shall not exceed 114,282,676 shares. Pursuant to the relevant statutory provisions, cancellation may not be effected earlier than March 18, 2008.

Legal proceedings

The Company and certain of its (former) group companies are involved as a party in legal proceedings, including regulatory and other governmental proceedings, relating to such matters as competition issues, commercial transactions, product liability, participations and environmental pollution. In respect of antitrust laws, the Company and certain of its (former) group companies are involved in investigations by competition law authorities in several jurisdictions and are engaged in litigation in this respect

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Since the ultimate disposition of asserted claims and proceedings and investigations cannot be predicted with certainty, an adverse outcome could have a material adverse effect on the Company s consolidated financial position and consolidated results of operations for a particular period.

For a description of the legal proceedings relating to asbestos, MedQuist, LG.Philips LCD and CRT investigations and other matters, please refer to note 27.

IFRS-only

Currently, Philips primary external and internal reporting is based on US GAAP. In addition, Philips issues quarterly and annual financial information prepared in accordance with International Financial Reporting Standards (IFRS).

The US Securities and Exchange Commission (SEC) has issued a final ruling that eliminates the requirement that Foreign Private Issuers such as Philips file US GAAP-based financial statements (or a reconciliation thereto) and will accept reporting based solely on IFRS.

Consequently, Philips will simplify its reporting by moving to IFRS as its sole reporting standard no later than from January 1, 2009, and will discontinue the use of US GAAP as of the same date.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Proposed dividend to shareholders

Outlook

Proposed dividend to shareholders

Pursuant to article 34 of the articles of association of Royal Philips Electronics, first a dividend will be declared on preference shares out of net income. The remainder of the net income, after reservations made with the approval of the Supervisory Board, shall be available for distribution to holders of common shares subject to shareholder approval after year-end. As of December 31, 2007, the issued share capital consists only of common shares; no preference shares have been issued.

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 progress of the current share repurchase program, will result in an expected dividend of 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 net income for the financial year 2007 has been retained by way of reserve. The balance sheet presented in this report, as part of the consolidated financial statements for the period ended December 31, 2007, is before dividend, which is subject to shareholder approval after year-end

Outlook

With our portfolio restructuring nearing completion, and having once again delivered on our targets, we look forward with confidence. 2008 is going to be a challenging but exciting year for Philips one in which we expect to take further solid steps towards achieving our Vision 2010 objectives.

The successful integration of acquisitions will be high on the management agenda for 2008. We completed the Genlyte acquisition in late January 2008 and expect to complete the announced acquisition of Respironics in the early part of this year. Following the completion of these acquisitions, we will be in a position to inform the market on the contribution of the sectors to the realization of our Vision 2010 plans; this will include our objective for return on invested capital.

We also expect to make substantial progress towards achieving an efficient balance sheet, which we will continue to base on an A-/A3 credit rating with both our rating agencies. We plan to continue the responsible sell-down of our remaining stakes during the year and we expect that our recently announced EUR 5 billion share repurchase program will be largely completed by the end of 2008.

While we recognize the market s caution on 2008 macro-economic developments particularly in North America and Europe we are confident that our sustained growth in the emerging markets, a strong innovation pipeline, a balanced portfolio and synergies from our acquisitions will allow us to continue on our improvement path through 2008 and to meet our targets as set out in Vision 2010.

Amsterdam, February 18, 2008

Board of Management

Our 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.

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.

2007

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

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. 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.

2008

Medical Systems

Medical Systems

Philips innovative healthcare solutions are designed to make a difference in how clinicians diagnose, treat and monitor disease, and allow them to focus more on their patients.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

6%
currency-comparable growth of order intake at Medical Systems

Human insight is combined with a solid clinical understanding to create integrated offerings across the cycle of care.

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 that begins on page 93 of this Annual Report.

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.

Medical Systems

With regard to sourcing, please refer to the business description of Philips Supply Management that begins on page 96 of this Annual Report.

Progress against targets

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.

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 multi-disciplinary 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

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

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.

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.

Philips MRI Breast Solution is fast, easy and accurate. It enables physicians to provide patients with the best diagnostic information and, if needed, to perform MRI-guided biopsies, helping patients avoid unnecessary stress.

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.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Medical Systems

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.

2007 financial performance

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.

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.

EBITA 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.

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

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.

Key data

in millions of euros

	2005[1)]	2006[1)]	2007
Sales	6,013	6,448	6,470
Sales growth			
% increase, nominal	9	7	0
% increase, comparable	8	8	4
EBITA	768	861	875
as a % of sales	12.8	13.4	13.5
EBIT	688	734	743
as a % of sales	11.4	11.4	11.5
Net operating capital (NOC)	3,179	4,125	4,104
Cash flows before financing activities	505	(427)	420
Employees (FTEs)	24,221	26,203	27,441

1) Restated to present the MedQuist business as a

discontinued operation

For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

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.

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 non-hospital 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.

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.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Domestic Appliances and Personal Care

Domestic Appliances and Personal Care

More than 15 million consumers around the world already use a Philips Sonicare toothbrush. With the launch of the FlexCare model developed in cooperation with a team of periodontists and bioengineers Philips Sonicare once again raises the bar for premium power toothbrushes.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

28%
comparable sales growth in emerging markets for DAP

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.

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 ED 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 that begins on page 96 of this Annual Report.

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.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Domestic Appliances and Personal Care

With Philips Arcitec, men can be confident that they ll get a perfectly close shave, even on their neck. Three independently flexing heads ensure optimum skin contact in curved areas.

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 proof-points 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-lnvest , 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.

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.

The Senseo coffee system from Philips and Sara Lee/DE offers a winning combination of sensational-tasting coffee, cool design and easy-to-use technology.

Table of Contents

Domestic Appliances and Personal Care

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.

2007 financial performance

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.

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.

Key data

in millions of euros

	2005	2006	2007
Sales	2,194	2,532	2,968
Sales growth			
% increase, nominal	7	15	17
% increase, comparable	6	11	15
EBITA	328	378	523
as a % of sales	14.9	14.9	17.6
EBIT	324	370	510
as a % of sales	14.8	14.6	17.2
Net operating capital (NOC)	370	1,138	1,136
Cash flows before financing activities	384	(287)	415
Employees (FTEs)	8,203	9,933	9,881

For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information

Compared to 2006, EBITA 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. EBITA improvements were visible both in absolute amounts and relative to sales in all businesses.

EBIT 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.

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.

Consumer Electronics

18

CES Innovation Awards for Consumer Electronics

We have taken the notion of immersive technology a dramatic step further with our new Aurea FlatTV. Aurea radiates light, color and sound from its unique active frame, creating a truly seductive ambient viewing experience.

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.

Placing consumers needs at the very heart of its strategy and activities, Philips Consumer Electronics (CE) is dedicated to providing consumers with great 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.

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.

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

Having passed the milestone of selling its one millionth Digital PhotoFrame, Philips has launched a new range of the stylish, high-resolution digital picture displays. The 2007 collection includes 5.6-inch and 10-inch models capable of storing up to 1000 images.

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 that begins on page 96 of this Annual Report.

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, with 9% comparable growth in the second half of the year. 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 co-operation 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 EBITA 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 touch-points, in particular delivering consistent top-tier results above 60% levels for the Ambilight Flat TV category.

In 2007, Philips added mobile phone company Nokia to its partnerships in consumer electronics accessories. The Made for Nokia XpressMusic range of audio headphones is designed to deliver highest-quality multimedia entertainment for Nokia s growing portfolio of music-optimized devices and smartphones.

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.

2007 financial performance

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.

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 EBITA of EUR 325 million, or 3.1% of sales, compared to 3.0% in 2006, in line with the target set for the division. Significant margin pressure at Connected Displays,

Key data

in millions of euros

	2005	2006	2007
Sales	10,422	10,576	10,362
Sales growth			
% increase (decrease), nominal	5	1	(2)
% increase, comparable	5	5	1
EBITA	405	314	325
as a % of sales	3.9	3.0	3.1
EBIT	404	313	322
as a % of sales	3.9	3.0	3.1
Net operating capital (NOC)	(296)	(228)	(246)
Cash flows before financing activities	548	248	357
Employees (FTEs)	15,537	14,486	13,516

For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information

particularly in the US, was more than offset by higher EBITA in the other businesses.
EBIT 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.

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.

Lighting

48%

of Lighting sales attributable to Green Products

The LED-based Living Colors lets people create whatever atmosphere they like in their room by choosing from 16 million LED colors with a simple remote control.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

We are building a strong position through the complete solid-state lighting value chain for future growth in energy-efficient lighting solutions using LED sources.

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 effciency, 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 that begins on page 96 of this Annual Report.

At the Dutch coastal town of Breskens, the promenade is now lit by a combination of Philips CitySoul luminaires and CosmoPolis light sources. Road safety, energy effciency, respect for the environment and aesthetics were key considerations for the new lighting scheme.

Progress against targets

In the Annual Report 2006, Lighting identifed 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 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

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

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

In the frozen food department of supermarkets, the performance of LEDs in freezers is far superior to that of the customary fluorescent lamps in terms of light output, energy efficiency and lifetime.

we continue to develop and invest in new OLED (Organic LED) and solid-state laser activities.

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 in-store 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).

2007 financial performance

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).

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

Key data

in millions of euros

	2005	2006	**2007**
Sales	4,775	5,466	**6,093**
Sales growth			
% increase, nominal	6	14	**11**
% increase, comparable	4	8	**6**
EBITA	508	608	**722**
as a % of sales	10.6	11.1	**11.9**
EBIT	499	577	**675**
as a % of sales	10.5	10.6	**11.1**
Net operating capital (NOC)	2,491	2,527	**3,886**
Cash flows before financing activities	(236)	451	**(648)**
Employees (FTEs)	45,649	47,739	**54,323**

For a reconciliation to the most directly comparable US GAAP measures, seethe chapter Reconciliation of non-US GAAP information

---

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%).

EBITA 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 EBITA following the successful integration of PLI, and lower losses related to the fluorescent-based backlighting solutions business which we exited in Q1 2007.

EBIT 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).

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.

Table of Contents

Innovation & Emerging Businesses

Philips Design s Skin Probes, winner of the Red Dot
best of the best 2007.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Introduction

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.

Key data

in millions of euros

	2005	2006	2007
Sales	1,905	1,493	703
Sales growth			
% decrease, nominal	(18)	(22)	(53)
% increase (decrease), comparable	(5)	(9)	32
EBIT	(165)	(94)	(101)
as a % of sales	(8.7)	(9)	(14.4)
EBITA Corporate Technologies	(108)	(91)	(76)
EBITA Corporate Investments/ Other	(57)	17	(5)
EBITA CHS		(2)	(2)
EBITA	(165)	(76)	(83)
as a % of sales	(8.7)	(5.1)	(11.8)
Net operating capital (NOC)	226	748	1,001
Cash flows before financing activities	(96)	(625)	(348)
Employees (FTEs)	15,130	9,852	7,638

For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information.

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.

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 end-users 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 innovative 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,

Philips Research has developed the SmartExam system dedicated scan-planning software that makes MRI scanners easy to operate, while also shortening scanning time and increasing the reproducibilrty of the images obtained.

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.

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 high-speed 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.

2007 financial performance

Corporate Technologies EBITA 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 EBITA 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.

The generation of (white) light with highly controlled color characteristics is a key enabling factor for solid-state lighting to enter the general lighting market. Lumiramic technology enables high-volume production of white LEDs with a very specific correlated color temperature, ensuring luminaire-to-luminaire consistency.

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 end-user 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.

8 Financial highlights	10 Message from the President	16 The Philips Group	62	The Philips sectors
				Innovation & Emerging Businesses

Corporate Investments

Divested activities

In line with Philips strategy to reduce its portfolio of non-core, 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 Financiére 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.

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.

2007 financial performance

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.

EBITA 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 activities within Philips Optical Storage (Automotive Playback Module), Philips Business Communication in China and Ommic, whereas 2006 included gains on divestments totaling EUR 44 million.

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.

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, 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.

In February 2007, Philips again headed the ranking of the World Intellectual Property Organization with 2,495 patent applications published in 2006.

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 US-based 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.

2007 financial performance

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.

EBITA 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.

EBIT 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.

With regard to sourcing, please refer to the business description of Philips Supply Management that begins on page 96 of this Annual Report.

With regard to regulatory requirements, please refer to regulatory requirements in the business description of Medical Systems that begins on page 69 of this Annual Report.

With regard to strategy and 2008 objectives, please refer to the Philips Healthcare strategy and 2008 objectives that begins on page 69 of this Annual Report.

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.

Key data

in millions of euros

	2005[1)]	2006[1)]	2007
Sales	136	167	197
Sales growth			
% increase (decrease), nominal	(60)	23	18
% increase (decrease), comparable	(20)	14	31
EBIT	(192)	(699)	(297)
EBITA Corporate & regional costs	(171)	(226)	(156)
EBITA Brand campaign	(138)	(126)	(111)
EBITA Service Units, Pensions, Other	117	(347)	(30)
EBITA	(192)	(699)	(297)
Net operating capital (NOC)	(531)	208	705
Cash flows before financing activities	1,736	(1,832)	5,253
Employees (FTEs)	6,312	6,879	5,299

1) Restated to present the MedQuist business as a discontinued operation For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information.

The EBITA of corporate and country overheads improved significantly in 2007 compared to 2006, primarily as a result of the simplification of the regional management structure and lower costs related to Sarbanes-Oxley compliance, which totaled EUR 26 million in 2006.

Investments in the global brand campaign amounted to EUR 111 million, a EUR 15 million reduction compared to 2006.

Pension and other postretirement benefit costs recorded under Group Management & Services were EUR 53 million lower than in 2006, largely due to an increase in plan assets in 2006.

The EBITA improvement in the Global Service Units and other businesses was primarily attributable to a product liability charge of EUR 256 million recognized in 2006. EBITA in 2007 was positively impacted by the result of the Real Estate Service Unit, with various gains on real estate transactions amounting to EUR 50 million, partly offset by additional legal expenses, mainly in the US, as well as investments in projects which target the further simplification of the service units. In 2006, real estate transactions yielded a profit of EUR 54 million.

On October 1, 2007, Philips completed the sale of the Finance Shared Services Centers to Infosys.

As of 2007, parts of the corporate services costs (EUR 162 million) have been allocated to the operating divisions, which drive and create value from these resources. Previous years have been restated accordingly.

Cash flows before financing activities turned from an outflow of EUR 1,832 million in 2006 to an inflow of EUR 5,232 million in 2007. This inflow was primarily attributable to cash receipts related to the sale of shares in TSMC (EUR 3,895 million) and LG.Philips LCD (EUR 1,547 million). Cash flows from operating activities improved, primarily due to EUR 742 million lower pension contributions as compared to 2006.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Group Management & Services

Investments in the global brand campaign are expected to be lower in 2008 at about EUR 95 million as the corporate campaign will be largely phased out over the coming two years. Pension and postretirement benefit costs are expected to be broadly in line with 2007.

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.

Risk management

The following sections present an overview of Philips approach to risk management and business control and a description of the nature and the extent of its exposure to risks. Philips recognizes different risk categories, namely Strategic risks, Market risks, Operational risks, Financial risks, and Compliance risks. These are further described in the section Risk categories of this Annual Report. The risk overview highlights the main risks that may hinder Philips in achieving the Vision 2010 objectives. The risk overview is, however, not exhaustive. Some risks not yet known to Philips, or currently believed not to be material, could later turn out to have a major impact on Philips businesses, objectives, revenues, income, assets, liquidity or capital resources.

The risk factors should be considered in connection with the forward-looking statements.

Our approach to risk management and business control

Risk management forms an integral part of business management. The company s risk and control policy is designed to provide reasonable assurance that objectives are met by integrating management control into the daily operations, by ensuring compliance with legal requirements and by safeguarding the integrity of the company s financial reporting and its related disclosures. It makes management responsible for identifying the critical business risks and for the implementation of fit-for-purpose risk responses. Philips risk management approach is embedded in the areas of corporate governance, Philips Business Control Framework and Philips General Business Principles, and in the actual periodic business planning and review cycles.

Corporate governance

Corporate governance is the system by which a company is directed and controlled. Philips believes that good corporate governance is a critical factor in achieving business success. Good corporate governance derives from, amongst other things, solid internal controls and high ethical standards. Risk management is a well-established part of Philips corporate governance structure.

The quality of Philips systems of business controls and the findings of internal and external audits are reported to and discussed in the Audit Committee of the Supervisory Board. Internal auditors monitor the quality of the business controls through risk-based operational audits, inspections of financial reporting controls and compliance audits. Audit committees at corporate and divisional levels meet on a quarterly basis to address weaknesses in the business control infrastructure as reported by the auditors or revealed by self-assessments, and to take corrective action where necessary. These audit committees are also involved in determining the desired company-wide internal audit coverage as approved by the Audit Committee of the Supervisory Board. An in-depth description of Philips corporate governance structure can be found in the chapter Corporate governance that begins on page 250 of this Annual Report.

Philips Business Control Framework

The Philips Business Control Framework (BCF), derived from the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework on internal control, sets the standard for risk management and business control in Philips. The objectives of the BCF are to maintain integrated management control of the company s operations, to ensure integrity of the financial reporting and business processes, as well as compliance with laws and regulations.

Philips has reviewed and further strengthened the fundamentals of its BCF over recent years. The first of these developments was the drive to harmonize enterprise resource planning systems, with SAP as the leading standard, enabling Philips to replace time-consuming manual controls with embedded, automated

controls. Thereafter, Philips introduced a program to systematically certify the critical IT systems against an internal control standard which is based on the generally accepted standards: control objectives for information and related technology (COBIT) and COSO. Furthermore, as part of BCF, Philips implemented a global standard for internal control over financial reporting (ICS). ICS supports management in a quarterly cycle of assessment and monitoring, enhancing transparency of its control environment. ICS has been deployed in all main reporting units, where business process owners perform an extensive number of controls, document the results each quarter, and take corrective action where necessary.

With respect to financial reporting, a structured company-wide assessment and monitoring process is in place to enable the Company s President/Chief Executive Officer and Chief Financial Officer to review and report on the effectiveness of risk management and business controls. Each quarter, division management and functional management at Group level involved in the external reporting process issue a formal certification statement to confirm the adequacy of the design and effectiveness of disclosure controls and internal controls over financial reporting, which is subject to review by the Board of Management. Annually, as part of the Annual Report process, management s accountability for business controls is enforced through the formal issuance of a Statement on Business Controls and a Letter of Representation by each business unit, resulting, via a cascade process, in a statement by each division. The Statements on Business Controls and Letters of Representation are subject to review by the Board of Management.

Section 404 Sarbanes-Oxley Act

Under section 404 of the US Sarbanes-Oxley Act, the Board of Management is, amongst other things, responsible for establishing and maintaining a system of internal control over US GAAP financial reporting for Philips. This internal control framework and its established accounting procedures and related controls are designed to provide reasonable assurance that assets are safeguarded, that the books and records properly reflect transactions necessary to permit preparation of financial statements, that policies and procedures are carried out by qualified personnel, and that published US GAAP financial statements are properly prepared and do not contain any material misstatements.

The Board of Management has assessed the design and operating effectiveness of controls within the scope of section 404 of the US Sarbanes-Oxley Act. The Board of Management s evaluation included controls at Group and division level, and transactional controls at significant locations across all of the Philips divisions. The scope also included relevant IT controls. Any deficiencies noted in design and operating effectiveness were not completely remedied were formally evaluated at year-end. The Board of Management s report, including its conclusions, regarding the effectiveness of its internal control over US GAAP financial reporting, can be found in the chapter Group financial statements of this Annual Report.

Philips General Business Principles

The Philips General Business Principles (GBP) govern Philips business decisions and actions throughout the world, applying equally to corporate actions and the behavior of individual employees. They incorporate the fundamental principles within Philips for doing business. The intention of the GBP is to ensure compliance with laws and regulations, as well as with Philips norms and values.

The GBP are available in most of the local languages and are an integral part of the labor contracts in virtually all countries where Philips has business activities. Responsibility for compliance with the principles rests principally with the management of each business. Every country organization and each main production site has a compliance officer. Confirmation of compliance with the GBP is an integral part of the annual Statement on Business Controls that has to be issued by the management

of each business unit. The GBP incorporate a whistleblower policy, standardized complaint reporting and a formal escalation procedure.

The global implementation of the One Philips Ethics Line ensures that alleged violations are registered and dealt with consistently within one company-wide system. In 2007, the French privacy authorities granted approval for the roll-out of the hotline in that country (completed in November). In Germany, the workers representation bodies also approved the introduction of a hotline. These approvals now ensure comprehensive company-wide implementation.

To drive the practical deployment of the GBP, a set of directives has been published, including a Supply Management Code of Ethics and a Financial Code of Ethics (www.philips.com/about/investor). In 2007, the updated version of the GBP Directives was approved and adopted, reflecting ongoing developments in codes of conduct and business integrity legislation. The main updates related to Philips endorsement of the UN Global Compact, policy on HIV/AIDS, health and safety policy, integrity and ethics in advertising, and in particular directives on the giving of gifts. To ensure compliance with the highest standards of transparency and accountability by all employees performing important financial functions, the Financial Code of Ethics contains, amongst other things, standards to promote honest and ethical conduct, and full, accurate and timely disclosure procedures to avoid conflicts of interest. The Company did not grant any waivers of the Financial Code of Ethics in 2007.

In order to publicize the updated GBP Directives, a global internal communications program was rolled out in the first half of 2007, with participation of the Board of Management and Group Management Committee and the respective Area and Country Management.

A company-wide toolkit has been developed and rolled out in 2007 for the compulsory registration of gifts to third parties to ensure full transparency in monitoring compliance with company standards.

To reinforce awareness of the need for compliance with the GBP, a web-based GBP training tool has been rolled out throughout the company in 22 different languages, covering more than 95% of the employees with on-line access. The e-training program for (new) compliance officers (including complaint-handling procedures and dilemma training) was updated in 2007. Furthermore, 2007 saw the development and worldwide roll-out of a train-the-trainer program for compliance awareness. Two-day training sessions were held in Latin America, Asia Pacific and Europe, with the remaining sessions scheduled for the first quarter of 2008. This program provides for an annual refresher course.

Risk categories

Taking risks is an inherent part of entrepreneurial behavior. A structured risk management process encourages management to take risks in a controlled manner. Philips has a structured risk management process in place that recognizes different risk categories at Strategic, Market, Operational, Financial and Compliance level.

Strategic risks address threats and opportunities that influence Philips strategic ambitions. The Market risks cover the effect that changes in the market may have on Philips. Risks related to areas such as economic and political developments are likely to affect all market participants in a similar manner. Operational risks include adverse unexpected developments resulting from internal processes, people and systems, or from external events that are linked to the actual running of each business (examples are product creation and supply chain management). Within the area of Financial risks, Philips identifies risks related to Treasury, Pensions, Fiscal and Legal. Compliance risks cover unanticipated failures to enact appropriate policies and procedures.

Strategic risks

Failure to deliver the Philips strategy may negatively impact shareholder value.

Through its Vision 2010, Philips aims to achieve profitable growth. Philips inability to transform this vision into action and to meet the financial targets as planned, may cause its share price to drop.

End-user-driven innovation and identification of new sources of differentiation are important in realizing Philips profitable growth ambitions.

Philips longer-term success depends on, amongst other things, innovation based on end-user insight using technology as value enabler. Moreover, some of Philips divisions continue to face diminishing opportunities to differentiate on

the basis of technical performance only. This makes the identification of new sources of both tangible and intangible differentiation essential.

Concurrently, it is imperative to understand changes in patterns related to end-user needs and preferences, and to align differentiation initiatives and innovations with the brand promise of sense and simplicity . If Philips fails in this area, its growth ambitions may be hampered.

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

Philips has recently completed and announced acquisitions, and may continue to do so in the future, exposing Philips to integration risks in areas such as sales and service force integration, logistics, regulatory compliance, information technology and finance. Integration difficulties and complexity may adversely impact the realization of an increased contribution from acquisitions. Furthermore, organizational simplification and resulting cost savings may be difficult to achieve.

The ability to secure and retain intellectual property rights for products, whilst maintaining overall competitiveness, is important.

Philips is dependent on its ability to obtain and retain licenses and other intellectual property (IP) rights covering its products and its design and manufacturing processes. The IP portfolio results from an extensive patenting process that could be influenced by, amongst other things, innovation. The value of the IP portfolio is dependent on the successful promotion and market acceptance of standards developed or co-developed by Philips. This is particularly important for Consumer Electronics where third-party licenses are important and a loss or impairment could negatively impact Philips results.

Philips ongoing investments in the sense and simplicity campaign, with a focus on simplifying the interaction with its customers, translating awareness into preference and improving its international brand recognition, could have less impact than anticipated.

Philips has made large investments in the reshaping of the Group into a more market-driven company focusing on delivering advanced and easy-to-use products and easy relationships with Philips for its customers. The brand promise of sense and simplicity is important for both external and internal development. If Philips fails to deliver on its sense and simplicity concept, its growth opportunities may be hampered.

Philips may be inflexible in adapting swiftly to changes in industry or market circumstances.

Paradigmatic shifts in the industry or market, like the transition from traditional lighting to energy-saving and LED lighting, may drastically change the business environment. If Philips is unable to recognize these changes in good time, or is too inflexible to rapidly adjust its business models, growth in ambitions and financial results could be affected.

Market risks

Philips overall performance in the coming years is dependent on realizing its growth ambitions in emerging markets.

Emerging markets are becoming increasingly important in the global market. Asia is an important production, sourcing and design center for Philips. Philips faces strong competition to attract the best talent in tight labor markets and intense competition from local Asian companies as well as other global players for market share in Asia. Philips needs to be part of the growth of emerging markets, invest in local talents, understand developments in end-user preferences and localize the portfolio in order to stay competitive. If Philips fails to achieve this, its growth ambition and financial results could be affected.

As Philips business is global, its operations are exposed to economic and political developments in countries across the world that could adversely impact its revenues and income.

The business environment is influenced by economic

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

and political uncertainties that continue to affect the global economy and the international capital markets. Economic and political developments could have a material adverse effect on Philips operating results. For example, the crisis that began in the US financial markets in the second half of 2007 has negatively impacted consumer borrowing and spending, and has exposed the cyclical commercial construction sector on which growth in the luminaires industry is strongly dependent.

Philips is exposed to markets with high complexity, and is facing continued competition.

Philips continually faces competitive challenges such as speed of innovation, fast-moving market trends, rapid technological change, evolving standards, shortening product life cycles, the cyclical nature of certain sectors and price erosion. Earnings improvement is highly exposed to these increased competitive challenges, which requires margin management through measures such as price management, cost reduction and/or efficiency increase. One example is solid-state lighting and the fast-growing LED market. If Philips cannot quickly offset margin erosion by upgrading its offering via, for instance, innovation or differentiation, cost reduction and/or efficiency measures, operating results may be hampered.

Philips global presence exposes the company to regional and local regulatory rules which may interfere with the realization of business opportunities and investments in the countries in which Philips operates.

Philips has established subsidiaries in over 60 countries. These subsidiaries are exposed to changes in governmental regulations and unfavorable political developments, which may limit the realization of business opportunities or impair Philips local investments. An increased focus on medical and health care increases the exposure to highly regulated markets, where obtaining clearances or approvals for new products is of great importance, and the dependency on the funding available for healthcare systems. In addition, changes in reimbursement policies may affect spending on healthcare technology. For example, as evidenced during 2007, cuts in reimbursement for imaging services mandated under the US Deficit Reduction Act (DRA) may continue to have an adverse impact on spending in US out-of-hospital markets.

Philips is exposed to increased scrutiny of possible anti-competitive market practices.

Philips is facing increased scrutiny of possible anti-competitive market practices by national and European authorities, especially in product segments where Philips has significant market shares. For example, Philips and certain of its (former) group companies are involved in investigations by competition law authorities in several jurisdictions into possible anti-competitive activities in the Cathode-Ray Tubes, or CRT, industry and are engaged in litigation in this respect. Philips financial position and results could be materially affected by an adverse final outcome of these investigations and litigation, as well as any potential claims in this respect. Furthermore, increased scrutiny may hamper planned growth opportunities provided by potential acquisitions.

Operational risks

Integral customer management is important for maintaining a sustainable competitive advantage. A set-back in Global Key Account Management or Category Management could hamper expected growth and damage Philips image.

Philips commitment to sense and simplicity is not restricted to new products; it also covers the wide range of support facilities Philips offers to its customers. An example of this is the provision of category management solutions to key retailers for supporting consumers in their decision-making. A setback in the management of international key retail accounts could hamper growth and damage Philips reputation and brand image.

Failure to achieve improvements in Philips product creation process and/or increased speed in innovation-to-market may hamper Philips profitable growth ambitions.

Further improvements in Philips product creation process, ensuring timely delivery of new products at lower cost and upgrading of customer service levels to create sustainable competitive advantages, are important in realizing Philips profitable growth ambitions. The emergence of new low-cost players, particularly in Asia, further underlines the importance of improvements in the product creation process. In addition, if Philips fails to accelerate its innovation-to-market processes and fails to ensure that end-user insights are fully captured and translated into product creations that improve product mix and consequently contribution, it may face an erosion of its market share and competitiveness.

If Philips is unable to ensure effective supply chain management, it may be unable to sustain its competitiveness in its markets.

Philips is continuing the process of creating a leaner supply base with fewer suppliers, while maintaining dual sourcing strategies where possible. This strategy strongly

supports close cooperation with suppliers to enhance, amongst others, time to market and quality. In addition, Philips is continuing its initiatives to reduce assets through outsourcing. These processes may result in increased dependency.

Due to the fact that Philips is dependent on its personnel for leadership and specialized skills, the loss of its ability to attract and retain such personnel would have an adverse effect on its business.

The retention of talented employees in sales and marketing, research and development, finance and general management, as well as of highly specialized technical personnel, especially in transferring technologies to low-cost countries, is critical to Philips success. The loss of specialized skills could also result in business interruptions.

Diversity in the IT landscape could result in ineffective or inefficient business management. IT outsourcing and off-shoring strategies could result in complexities in service delivery and contract management. Furthermore, we observe a global increase in IT security threats and higher levels of professionalism in computer crime, posing a risk to the confidentiality, availability and integrity of data and information.

Philips is engaged in a continuous drive to create a more open, standardized and, consequently, more cost-effective IT landscape. This is leading to an approach involving further outsourcing, offshoring, commoditization and ongoing reduction in the number of IT systems. The global increase in security threats and higher levels of professionalism in computer crime have raised our awareness of the importance of effective IT security measures, including proper identity management processes to protect against unauthorized systems access. The integration of new companies and successful outsourcing of business processes are highly dependent on secure and well controlled IT systems.

Warranty and product liability claims against Philips could cause Philips to incur significant costs and affect Philips results as well as its reputation and relationships with key customers.

Philips is from time to time subject to warranty and product liability claims with regard to product performance. Philips could incur product liability losses as a result of repair and replacement costs in response to customer complaints or in connection with the resolution of contemplated or actual legal proceedings relating to such claims. In addition to potential losses arising from claims and related legal proceedings, product liability claims could affect Philips reputation and its relationships with key customers, both customers for end products and customers that use Philips products in their production process. As a result, product liability claims could impact Philips financial position and results.

Financial risks

Philips is exposed to a variety of financial risks, including currency risk, interest rate risk, liquidity risk, equity price risk, commodity price risk, credit risk, country risk and other insurable risks which may impact Philips results.

Philips is a global company and as a direct result the financial results of the Group may be impacted through currency fluctuations. Furthermore, Philips is exposed to other movements in the financial markets in the form of interest rate risk, commodity price risk and also equity price risk as Philips holds minority stakes in a number of listed companies where market value currently exceeds the equity investment reported in the financial statements. A decline in the market value of these investments could result in a future impairment. Moreover, failure to further improve capital management may reduce investor, creditor and market confidence.

For further analysis, please refer to the section Treasury that begins on page 104 of this Annual Report.

Philips has deflned-beneflt pension plans in a number of countries. The funded status and the cost of maintaining these plans are influenced by financial market and demographic developments, creating volatility in Philips results.

The majority of employees in Europe and North America are covered by these plans. The accounting for deflned-beneflt pension plans requires management to determine discount rates, expected rates of compensation and expected returns on plan assets. Changes in these variables can have a significant impact on the projected benefit obligations and net periodic pension costs. A negative performance of the financial markets could have a material impact on funding requirements and net periodic pension costs and also affect the value of certain financial assets of the company.

For further analysis of pension-related exposure to changes in financial markets, please refer to the section Pensions that begins on page 109 of this Annual Report, and for quantitative and qualitative disclosure of pensions, please refer

to note 20.

Philips is exposed to a number of different tax uncertainties which could have a significant impact on local tax results.

Philips is exposed to a number of different tax uncertainties which could result in double taxation, penalties and interest payments. These include, amongst others, transfer pricing uncertainties on internal cross-border deliveries of goods and services, tax uncertainties related to acquisitions and divestments, tax uncertainties related to the use of tax credits and permanent establishments, and tax uncertainties due to losses carried forward and tax credits carried forward. Those uncertainties may have a significant impact on local tax results.

For further details, please refer to the section Fiscal that begins on page 111 of this Annual Report.

Legal proceedings covering a range of matters are pending in various jurisdictions against Philips and its (former) group companies. Due to the uncertainty inherent in legal proceedings, it is difficult to predict the final outcome. Adverse outcomes might impact Philips financial position and results.

Philips, including a certain number of its (former) group companies, is involved in legal proceedings relating to such matters as competition issues, commercial transactions, product liability (including allegations of personal injury from alleged asbestos exposure), participations and environmental pollution. Since the ultimate disposition of asserted claims and proceedings, or the impact of any claims that may be asserted in the future, cannot be predicted with certainty, Philips financial position and results of operations could be affected by adverse outcomes.

Please refer to note 27 for additional disclosure relating to specific legal proceedings.

Compliance risks

Exposure to non-compliance with general business principles in emerging markets.

Corporate governance systems, including information structures and ethical standards, are less developed in emerging markets compared to mature markets. Realization of growth targets in emerging markets exposes Philips management to risk of non-compliance with general business principles. Examples include commission payments to third parties, remuneration payments to agents, distributors, commissioners and the like (Agents), or the acceptance of gifts, which may be considered normal local business practice. For further details, please refer to the section Philips General Business Principles of the Risk Management chapter of this Annual Report.

Reliability of reporting, correctness of disclosures and safeguarding of assets.

The reliability of reporting is important in ensuring that management decisions for steering the businesses and managing both top-line and bottom-line growth are based on top-quality data. Flaws in internal control systems could adversely affect the financial position and results and hamper expected growth.

The correctness of disclosures provides investors and other market professionals with significant information for a better understanding of Philips businesses. Imperfections or lack of clarity in the disclosures could create market uncertainty regarding the reliability of the data presented and may have a negative impact on the Philips share price.

Compliance procedures have been adopted by management to ensure that the use of resources is consistent with laws, regulations and policies, and that resources are safeguarded against waste, loss and misuse. Ineffective compliance procedures relating to the safeguarding of assets could have an adverse effect on the financial results.

Non-compliance with data privacy and product security laws

Philips brand image and reputation will be adversely impacted by non-compliance with the various (patient) data privacy and (medical) product security laws. Privacy and product security issues may arise with respect to remote access or monitoring of patient data or loss of data on customers systems.

Details of financial risks

This section provides further details of the financial risks, which are categorized along the lines of the corporate processes Treasury, Pensions, Fiscal and Legal.

Treasury

Philips is, as mentioned before, exposed to several types of financial risk. This section further analyzes financial risks. Philips does not purchase or hold derivative instruments for speculative purposes. Information regarding financial instruments is included in note 36 and note 69 of the notes to the financial statements.

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

This Treasury section up to Other insurable risks forms an integral part of the IFRS financial statements.

Currency risk

Currency fluctuations may impact Philips financial results.

Philips is exposed to currency risk in the following areas:

- Transaction exposures, such as forecasted sales and purchases and on-balance-sheet receivables/payables resulting from such transactions;
- Translation exposure of net income in foreign entities;
- Translation exposure of foreign-currency intercompany and external debt and deposits;
- Translation exposure of equity invested in consolidated foreign entities;
- Exposure to equity interests in non-functional-currency equity-accounted investees and available-for-sale investments.

It is Philips policy that significant transaction exposures are hedged by the businesses. Accordingly, all businesses are required to identify and measure their exposures resulting from material transactions denominated in currencies other than their own functional-currency. Philips policy generally requires committed foreign currency exposures to be fully hedged using forwards. Anticipated transactions may be hedged using forwards or options or a combination thereof. The hedge tenor varies per business and is a function of the ability to forecast cash flows and the way in which the businesses can adapt to changed levels of foreign-currency exchange rates. As a result, hedging activities may not eliminate all currency risks for these transaction exposures. Generally, the maximum tenor of these hedges is 18 months.

The following table outlines the estimated nominal value in millions of euros for transaction exposure and related hedges for Philips most significant currency exposures as of December 31, 2007:

Estimated transaction exposure and related hedges

in millions of euros

	maturity 0-60 days		maturity over 60 days	
	exposure	hedges	exposure	hedges
Hedges of receivable				
USD vs EUR	425	(379)	1,615	(1,014)
JPY vs EUR	32	(31)	118	(101)
GBP vs EUR	83	(81)	105	(72)
PLN vs EUR	56	(53)	110	(69)
EUR vs SEK	33	(33)	33	(21)
USD vs AED	8	(5)	61	(31)
EUR vs USD	155	(138)	606	(127)
Hedges of payables				
USD vs CAD	(20)	18	(52)	40
PLN vs EUR	(49)	38	(285)	163
USD vs EUR	(696)	649	(1,477)	969
EUR vs GBP	(18)	16	(77)	67
MYR vs USD	(12)	8	(51)	26
MXN vs USD	(19)	15	(67)	36
EUR vs SEK	(48)	48	(81)	49

The first currency displayed is the exposure that is being hedged followed by the functional currency of the hedging entity.

The derivatives related to transactions are, for hedge accounting purposes, split into hedges of on-balance-sheet accounts receivable/payable and forecasted sales and purchases. Changes in the value of on-balance-sheet foreign-currency accounts receivable/payable, as well as the changes in the fair value of the hedges related to these exposures, are reported in the income statement under cost of sales. Hedges related to forecasted transactions are accounted for as cash flow hedges.

The results from such hedges are deferred in other comprehensive income within equity. Currently, a gain of EUR 29 million is deferred in equity as a result of these hedges. The result deferred in equity will mostly be released to earnings during 2008 at the time when the related hedged transactions affect the income statement. During 2007, a net gain of EUR 4 million was recorded in the income statement as a result of ineffectiveness of transaction hedges.
The total net fair value of hedges related to transaction exposure as of December 31, 2007 was an unrealized gain of EUR 19 million. The most significant transaction exposures relate to the US dollar and the pound sterling. An instantaneous 10% increase in the value of the euro against all currencies would lead to a decrease in the value of the derivatives of EUR 13 million, including a EUR 45 million decrease related to deals of the euro against the US dollar offset by a EUR 19 million increase due to deals of the euro against the pound sterling. The net change in value in other derivatives would be an increase of EUR 13 million with the most significant other currency pair being the euro against Japanese yen for an amount of EUR 10 million.
The change in fair value of the hedges of transactions in the case of a 10% appreciation in the euro for deals of the euro against the US dollar and the euro against the pound sterling can be further broken down as follows:

Sensitivity to a 10% increase in euro versus USD

in millions of euros

	maturity 0-12 months	maturity > 12 months
Change in fair value of forwards	(49)	2
Change in fair value of options	2	0

Sensitivity to a 10% increase in euro versus GBP

in millions of euros

	maturity 0-12 months	maturity > 12 months
Change in fair value of forwards	18	1

Philips does not hedge the translation exposure of net income in foreign entities.
Foreign exchange exposure also arises as a result of inter-company loans and deposits. Where the Company enters into such arrangements the financing is generally provided in the functional currency of the subsidiary entity. The currency of the Company s external funding and liquid assets is matched with the required financing of subsidiaries either directly by external foreign currency loans and deposits, or synthetically by using foreign exchange derivatives. In certain cases where group companies may also have external foreign currency debt or liquid assets, these exposures are also hedged through the use of foreign exchange derivatives. Changes in the fair value of hedges related to this translation exposure are recognized within financial income and expenses in the income statement and are largely offset by the revaluation of the hedged items. The total net fair value of these derivatives as of December 31, 2007, was an unrealized gain of EUR 89 million. An instantaneous 10% increase in the value of the euro against all currencies would lead to an increase in the value of the derivatives of EUR 348 million, including a EUR 192 million increase due to the US dollar and a EUR 163 million increase due to the pound sterling.
Translation exposure of equity invested in consolidated foreign entities is partially hedged. If a hedge is entered into, it is accounted for as a net investment hedge. As at December 31, 2007, the total fair value of derivatives accounted for as net investment hedges was EUR 12 million. An instantaneous 10% increase in the value of the euro against all currencies would lead to an increase in the value of these derivatives of EUR 24 million. During 2007, Philips recorded a gain of EUR 23 million in other comprehensive income under currency translation differences as a result of net investment hedges.
Philips does not currently hedge the foreign exchange exposure arising from equity interests in non functional currency equity-accounted investees and available-for-sale financial assets.

Interest rate risk

Philips has significant outstanding debt, which creates an inherent interest rate risk. Failure to effectively hedge this risk could negatively impact financial results. At year-end, Philips held EUR 8,769 million in cash and cash equivalents and had total long-term debt of EUR 1,212 million and total short-term debt of EUR 2,345 million. At December 31, 2007, Philips had a ratio of fixed-rate long-term debt to total outstanding debt of approximately 34%, compared to 74% one year earlier. Philips partially hedges the interest-rate risk inherent in the external debt. As of year-end 2007, the company had six USD interest rate swaps outstanding, on which the company receives fixed interest and pays floating interest on the equivalent of

EUR 347 million. Fair value hedge accounting is applied to these interest rate swaps. Including the effect of the interest rate swaps the ratio of fixed long-term debt to total outstanding debt as at December 31, 2007, is 24%, compared to 64% one year earlier. Total short-term debt includes three bonds for a total book value of EUR 1,692 million of which EUR 130 million is due to mature in February 2008, while the remaining balance of EUR 1,562 million matures in May 2008.

Certain past interest rate hedges related to bonds were unwound during 2004. The fair value adjustments to the bonds are amortized to the income statement based on the recalculated effective yield. In 2007, a gain of EUR 5 million was released to the income statement.

As of December 31, 2007, the majority of debt consisted of bonds.

A sensitivity analysis shows that if long-term interest rates were to decrease instantaneously by 1% from their level of December 31, 2007, with all other variables (including foreign exchange rates) held constant, the fair value of the long-term debt would increase by approximately EUR 63 million. This change would be partially offset by the change in fair value of the interest rate swaps, which would increase by EUR 38 million. If there was an increase of 1% in long-term interest rates, this would reduce the market value of the long-term debt by approximately EUR 63 million. This change would be partially offset by the change in fair value of the interest rate swaps, which would decrease by EUR 33 million.

If interest rates were to increase instantaneously by 1% from their level of December 31, 2007, with all other variables held constant, the annualized net interest expense would decrease by approximately EUR 54 million due to Philips significant cash position. This impact is based on the outstanding net cash position at December 31, 2007.

Liquidity risk

The rating of the Company s debt by major rating services may improve or deteriorate. As a result, Philips borrowing capacity may be influenced and its financing costs may fluctuate. Philips has various sources to mitigate the liquidity risk for the group, including EUR 8,769 million in cash and cash equivalents, a USD 2,500 million Commercial Paper Program, and a USD 2,500 million committed revolving facility that could serve as back-up for short-term financing requirements that would normally be satisfied through the Commercial Paper Program and EUR 4,464 million of investments in its main available-for-sale securities and listed equity-accounted investees at market value at December 31, 2007. The Company has a lock-up period associated with the sale of shares in TPV Technology that expires in September 2008 and a further lock up period associated with the sale of shares in LG.Philips LCD that expired in January 2008.

Equity price risk

Philips is a shareholder in several publicly listed companies including TSMC, LG.Philips LCD and TPV Technology Ltd. As a result, Philips is exposed to potential financial loss through movements in the share prices. The aggregate equity price exposure of publicly listed investments in its main available-for-sale securities, trading securities and listed equity-accounted investees amounted to approximately EUR 4,464 million at year end 2007 (2006: EUR 9,524 million including shares that were sold during 2007). Philips also holds options on the shares of TPV through a convertible bond issued to Philips in September 2005, the face value of the bond being the USD equivalent of EUR 143 million and the fair value of the option at year-end EUR 47 million. Philips does not hold derivatives in its own stock or in the above-mentioned listed companies except for the embedded derivatives in the convertible bond already mentioned.

Commodity price risk

Philips is a purchaser of certain base metals, precious metals and energy. Philips hedges certain commodity price risks using derivative instruments to minimize significant, unanticipated earnings fluctuations caused by commodity price volatility. The commodity price derivatives that Philips enters into are concluded as cash flow hedges to offset forecasted purchases. Currently, a loss of EUR 1 million is deferred in equity as a result of these hedges. A 10% increase in the market price of all commodities as at December 31, 2007, would increase the fair value of the derivatives by EUR 4 million.

Credit risk

Credit risk represents the loss that would be recognized at the reporting date if counterparties failed completely to perform their payment obligations as contracted. Credit risk is present within Philips trade receivables. To reduce exposure to credit risk, Philips performs ongoing evaluations of the financial condition of its customers and adjusts payment terms and credit limits when appropriate.

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

Philips invests available cash and cash equivalents with various financial institutions and is exposed to credit risk with these counterparties. Philips is also exposed to credit risks in the event of non-performance by counterparties with respect to financial derivative instruments.

Philips actively manages concentration risk and on a daily basis measures the potential loss under certain stress scenarios, should a financial counterparty default. These worst-case scenario losses are monitored and limited by the company. As of December 31, 2007 Philips had credit risk exceeding EUR 25 million with the following number of counterparties:

Credit risk with number of counterparties

	25-100 million	100-500 million	500-2,000 million
AAA-rated governments	1	2	2
AAA-rated government banks	1		2
AAA-rated bank counterparties			1
AA-rated bank counterparties	5	2	
A rated bank counterparties	2		

The company does not enter into any financial derivative instruments to protect against default by financial counterparties. However, where possible the company requires all financial counterparties with whom it deals in derivative transactions to complete legally enforceable netting agreements under an International Swap Dealers Association master agreement or otherwise prior to trading, and whenever possible, to have a strong credit rating from Standard & Poor s and Mood s Investor Services. Philips also regularly monitors the development of credit default swap prices of its financial counterparties. Wherever possible, cash is invested and financial transactions are concluded with financial institutions with strong credit ratings or with governments or government-backed institutions. As at December 31, 2007, Philips expects no impact as a result of the sub-prime mortgage crisis.

Country risk

Philips is exposed to country risk by the very nature of running a global business. Country risk is the risk that political, legal, or economic developments in a single country could adversely impact our performance. The country risk per country is defined as the sum of the equity of all subsidiaries and associated companies in country cross-border transactions, such as intercompany loans, guarantees (unless country risk is explicitly excluded in the guarantee), accounts receivable from third parties and intercompany accounts receivable. The country risk is monitored on a regular basis.

As of December 31, 2007, the Company had country risk exposure in the Netherlands of EUR 13 billion and in the United States of EUR 6 billion. Other countries exceeding EUR 1 billion but less than EUR 5 billion included Belgium, China (including Hong Kong), South Korea and Taiwan. Countries where the risk exceeded EUR 200 million included Austria, France, Italy, Japan, Malaysia, Poland, Spain, Switzerland and the United Kingdom. The degree of risk of a country is taken into account when new investments are considered. The Company does not, however, use financial derivative instruments to hedge country risk.

Other insurable risks

Philips is covered for a range of different kinds of losses by global insurance policies in the areas of property damage, business interruption, general and products liability, transport, directors and officers liability, employment practice liability, fraud, and aviation product liability.

To lower exposures and to avoid potential losses, Philips has a worldwide Risk Engineering program in place. The main focus in this program is on property damage and business interruption risks, which also include interdependencies. Philips sites, and also a limited number of sites of key suppliers, are inspected on a regular basis by the Risk Engineering personnel of the insurer. Inspections are carried out against predefined Risk Engineering standards which are agreed between Philips and the insurers. Recommendations are made in a Risk Management report and are reviewed centrally. This is the basis for decision-making by the local management of the business as to which recommendations will be implemented. For all policies, deductibles are in place, which vary from EUR

250,000 to EUR 500,000 per occurrence and this variance is designed to differentiate between the existing risk categories within Philips. Above this first layer of working deductibles, Philips operates its own re-insurance captive, which during 2007 retained EUR 2.5 million per occurrence for the property damage and business interruption losses and EUR 5 million in the aggregate per year. For general and product liability claims, the captive retained EUR 1.5 million per claim and EUR 6 million in the aggregate. New contracts were signed on December 31, 2007 for the coming year, whereby the reinsurance captive retentions remained unchanged.

Fair value measurement

The company calculates the fair value of derivatives and sensitivities based on observed liquid market quotations. Where the instrument is not directly observable, the valuation techniques used are qualified and benchmarked regularly with industry.

Pensions

This section further analyzes the pension exposure and possible risks thereof.

Pension-related exposure to changes in financial markets.

With pension obligations in more than forty countries, Philips has devoted considerable attention and resources to ensuring disclosure, awareness and control of the resulting exposures.

Depending on the investment policies of the respective pension funds, developments in financial markets may have significant effects on the funded status and the net periodic pension cost (NPPC) of Philips pension plans. To monitor this exposure to investment risk, Philips uses a Global Risk Reward Model . The model, which covers approximately 95% of the company s total pension liabilities and contains separate modules for the Netherlands, the UK, the US and Germany, allows stochastic simulations of the pension accounting figures.

The dispersion of the outcomes of these simulations around their average (or expected) values provides an indication of Philips risk exposure. The bar charts below show the maximum deviations from the expected Funded Status as per year-end 2007 and year-end 2008 and the expected NPPC for 2008 and 2009, respectively, if the 5% worst possible outcomes are excluded. These Funded-Status-at-risk and NPPC-at-risk measures are based on the plan assets and liabilities and the bond and equity market valuations on December 31, 2006 and December 31,2007 respectively, and may therefore be seen as indicators of the funding and NPPC risks on these same dates.

The bar charts also show the impact of model updates and changes in economic assumptions to account for recent developments in financial markets and benefit from new modeling techniques. Their impact may be seen by comparing the first and the second bars in each of the charts below. The most important effects are increased estimates of interest rate risk, lower estimated equity risk and increased estimates of inflation risk. These effects are, however, more than offset by an increased diversification between regions and an increased correlation between interest rates and inflation.

The impact of plan changes, changes in investment policy and changes in financial market conditions during 2007 may be seen by comparing the second and the third bars in the graphs below. The differences between those bars are largely attributable to changes to the investment portfolio of the Dutch pension fund, which reduced its equity and real estate allocations in the last few months of the year. The proceeds of these changes were used to increase the fixed income allocation and reduce interest rate risk. The changes to the fund s investment portfolio were the first steps towards implementation of a change in its investment strategy. The remaining steps towards implementation are planned to be made in 2008.

The US plan has also changed its investment strategy. The change entails decreases in equity and interest rate risk. Some first steps towards implementation of this new strategy were made in 2007 and additional steps are planned to be made in 2008. The impact of the additional steps by the Dutch and the US pension funds towards full implementation of their revised strategies may be seen by comparing the third and the fourth bars in the graphs below.

The composition of the respective bars shows how funding risk may be attributed to economic factors (interest rate risk, equity risk, inflation risk and foreign exchange risk) and country factors (risk exposures in the Netherlands, the US, the UK and Germany). Because of the less than 100% (or even negative) correlation between the different economic and/or country factors, the total risk may well be lower than the sum of the underlying factors. This is called the diversification effect, which is also shown in the graphs.

Funded status

The model update and the changes in economic assumptions referred to above have caused an increase in the estimated total contribution of the respective risk factors to the overall Funded-Status-at-Risk. However, as this is more than offset by an increased diversification effect, the net impact has been a decrease in the estimated Funded-Status-at-Risk. The Funded Status-at-Risk has also decreased as a result of the aforementioned changes in the

investment portfolio of the Dutch pension fund. The additional changes in

investment policy, planned in the Netherlands and the US, to fully implement their new investment strategies will lead to a further reduction in Funded-Status-at-Risk.

Equity risk is the major source of risk to the Funded Status. It results from the relatively large allocation to equities in the US and the large absolute exposure to equities in the Dutch pension fund, even after the reduction in its equity allocation in the last few months of 2007. The contribution of interest rate risk results from the interest rate mismatches between assets and liabilities in the Netherlands, the US and Germany. Although interest rate risk in the Netherlands was reduced in the last few months of 2007, the Dutch pension fund still contributes most to interest rate risk. This will change as a result of the planned investment changes in 2008. Following these changes, the remaining exposure in the US will be the dominant contribution to interest rate risk. The Dutch pension fund contributes most to inflation risk, due to its size and indexation policy. Foreign exchange risk contributes relatively little to the Funded-Status-at-risk. The diversification effect is largely attributable to the positive correlation between inflation and interest rates and the negative correlation between bonds and equities.

The country decomposition shows that the Dutch pension fund contributes most to the Funded-Status-at-risk. Although its equity and real estate allocations were reduced in 2007, while its fixed income allocation was increased, the fund s remaining exposure to equity markets is still significant. This, combined with the size of the fund, explains the major part of its contribution to total risk.

NPPC

The aforementioned model update and the simultaneous changes in economic assumptions have increased the estimated NPPC-at-risk. It has not changed much as a result of the changed asset allocation. Nor is it expected to change much as a result of the additional changes planned for 2008. A lower Funded-Status-at-Risk does not necessarily lead to a lower NPPC-at-Risk.

The country decomposition shows that the Dutch pension fund contributes most to NPPC-at-risk. This is attributable to its size and its exposure to equities.

In summary, the estimated Funded-Status-at-risk decreased in 2007. NPPC-at-risk, on the other hand, has hardly changed. The lower Funded-Status-at-risk is attributable to the reduced asset-liability mismatch of the Dutch pension fund. The Dutch pension fund still contributes most to the risk statistics, due to its size and its exposure to equities. Some further risk reduction may be expected from the additional portfolio changes in the Netherlands and the US to fully implement their new investment strategies.

Fiscal

Philips is, as mentioned before, exposed to fiscal uncertainties. This section further describes this exposure.

Transfer pricing uncertainties

Philips has issued transfer pricing directives, which are in accordance with guidelines of the Organization of Economic Co-operation and Development. As transfer pricing has a cross-border effect, the focus of local tax authorities on implemented transfer pricing procedures in a country may have an impact on results in another country. In order to mitigate the transfer pricing uncertainties, audits are executed on a regular basis to safeguard the correct implementation of the transfer pricing directives.

Tax uncertainties on general service agreements and specific allocation contracts

Due to the centralization of certain activities in a limited number of countries (such as research and development costs, centralized costs for IT, and costs for corporate functions and head office), costs are also centralized. As a consequence, for tax reasons these costs and / or revenues must be allocated to the beneficiaries, i.e. the various Philips entities. For that purpose, apart from specific allocation contracts for costs and revenues, general service agreements (GSAs) are signed with a large number of entities. Tax authorities review the implementation of GSAs, often auditing on benefit test for a particular country or the use of tax credits attached to GSAs and royalty payments, and may reject the implemented procedures. Furthermore, buy in/out situations in the case of (de)mergers could affect the tax allocation of GSAs between countries. The same applies to the specific allocation contracts.

Tax uncertainties due to disentanglements and acquisitions

When a subsidiary of Philips is disentangled, or a new company is acquired, related tax uncertainties arise. Philips creates merger and acquisition (M&A) teams for these disentanglements or acquisitions. These teams consist of specialists from various corporate functions and are formed, amongst other things, to identify hidden tax uncertainties that could subsequently surface when companies are acquired and to avoid tax claims related to disentangled entities. These tax uncertainties are investigated and assessed to mitigate tax uncertainties in the future as much as possible. Several tax uncertainties may surface from M&A activities. Examples of uncertainties are: applicability of the participation exemption, allocation issues, and non-deductibility of parts of the purchase price.

Tax uncertainties due to permanent establishments

In countries where Philips starts new operations, the issue of permanent establishment may arise. This is due to the fact that when operations in new countries are led from other countries, there is a risk that tax claims will arise in the new country as well as in the initial country. Philips assesses these uncertainties before the new activities are started in a particular country.

Tax uncertainties of losses carried forward and tax credits carried forward

The value of the losses carried forward is not only a matter of having sufficient profits available within the loss-carried forward period, but also a matter of sufficient profits within the foreseeable future in the case of losses carried forward with an indefinite carryforward period. Valuation allowances of deferred tax asset positions are in place where considered necessary.

Legal

Please refer to note 27 for additional disclosure relating to specific legal proceedings.

Our leadership

The executive management of Philips is entrusted to its Board of Management under the supervision of the Supervisory Board. The Group Management Committee is the highest consultative body within Philips. This chapter presents the Board of Management, the Group Management Committee and the Supervisory Board as of December 31, 2007.

From left to right Gottfried Dutiné, Rudy Provoost, Pierre-Jean Sivignon, Theo van Deursen, Gerard Kleisterlee, Steve Rusckowski, Andrea Ragnetti

Gottfried Dutiné

1952, German

Executive Vice-President

Member of the Board of Management since April 2002 and member of the Group Management Committee since February 2002

Corporate responsibilities: Areas and Countries, Government Relations, Strategic Initiatives, Emerging Markets, Business KAM Board

Pierre-Jean Sivignon

1956, French

Executive Vice-President and Chief Financial Officer (CFO)

CFO and member of the Board of Management and the Group Management Committee since June 2005

Corporate responsibilities: Control, Treasury, Fiscal, Mergers & Acquisitions, Investor Relations, Information Technology, Pensions, Real Estate, Corporate Investments, Supply Management

Rudy Provoost

1959, Belgian

Executive Vice-President

Member of the Board of Management since April 2006, member of the Group Management Committee since August 2003 and CEO of the Consumer Electronics division since 2004

Corporate responsibilities: Consumer Electronics, International Retail Board Management, LG.Philips LCD

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

What we have changed in the way we approach our leadership is first of all that we have required everyone to look beyond the boundaries of his or her own activity.

Second, we have tried to create a culture where people are encouraged to take calculated risks, and where failure is not something never permitted. Failure is part of learning.

We have also tried to move away from big single initiatives to smaller experimental initiatives.

There is no one big bang that is suddenly going to get us into growth mode. Each of our leaders has to work on several initiatives. Some will fail and some will succeed. You nurture the ones that promise to be successful.

Gerard Kleisterlee speaking to Peter Lorange,
president of IMD, *in European* Business *Forum, spring 2007*

Gerard Kleisterlee
1946, Dutch
President/Chief Executive Officer (CEO) and Chairman of the Board of Management and the Group Management Committee
President/CEO and Chairman of the Board of Management since April 2001, member of the Board of Management since April 2000 and member of the Group Management Committee since January 1999
Corporate responsibilities: Communications, Internal Audit, Legal, Human Resources Management, Strategy, Technology Management, Consumer Healthcare Solutions

Steve Rusckowski
1957, American
Executive Vice-President
Member of the Board of Management since April 2007 and CEO of Philips Medical Systems since November 2006
Corporate responsibilities: Medical Systems, Healthcare New Business Development Board

Theo van Deursen
1946, Dutch
Executive Vice-President
Member of the Board of Management since April 2006, member of the Group Management Committee since April 2003 and CEO of the Lighting division since 2003
Corporate responsibilities: Lighting, Quality Policy Board, Technology New Business Development Board

Andrea Ragnetti
1960, Italian
Executive Vice-President
Member of the Board of Management since April 2006, member of the Group Management Committee since January 2003, Chief Marketing Officer since 2003 and CEO of the Domestic Appliances and Personal Care division since 2005
Corporate responsibilities: Domestic Appliances and Personal Care, Global Marketing Management, Design, Lifestyle New Business Development Board

Board of Management

The Board of Management operates under the chairmanship of the President/Chief Executive Officer. The members of the Board of Management have collective powers and responsibilities. They share responsibility for the management of Koninklijke Philips Electronics N.V. (the Company), the deployment of its strategy and policies, and the achievement of its objectives and results. The Board of Management has, for practical purposes, adopted a division of responsibilities reflecting the functional and business areas monitored and reviewed by the individual members.

According to the Company s corporate objectives and Dutch law, the Board of Management is guided by the interests of the Company and its affiliated enterprises within the Group, taking into consideration the interests of the Company s stakeholders, and is accountable for the performance of its assignment to the Supervisory Board and the General Meeting of Shareholders. The Rules of Procedure of the Board of Management are published on the Company s website (www.philips.com/investor).

In connection with the creation of the sectors Healthcare, Lighting and Consumer Lifestyle as of January 1, 2008, Steve Rusckowski became CEO of Healthcare as per January 1, 2008. With effect from the same date, Rudy Provoost, CEO of the Consumer Electronics division, has moved to the Lighting sector, transitioning to take over as CEO from Theo van Deursen, who will retire on April 1, 2008. Andrea Ragnetti, CEO of DAP, became CEO of the Consumer Lifestyle sector from January 1, 2008.

Corporate governance

A full description of the Company s corporate governance structure is published in the chapter Corporate governance of this Annual Report.

* Member of the Audit Committee

** Member of the Remuneration Committee

*** Member of the Corporate Governance and Nomination & Selection Committee

Group Management Committee

The Group Management Committee consists of the members of the Board of Management and certain key officers. Members other than members of the Board of Management are appointed by the Supervisory Board. The task of the Group Management Committee, the highest consultative body within Philips, is to ensure that business issues and practices are shared across Philips and to implement common policies.

Daniel Hartert

1958, German

Member of the GMC since August 2003 and CEO Imaging Systems business since September 2007

Corporate responsibilities: Imaging Systems business

Barbara Kux

1954, Swiss

Member of the GMC since October 2003 and Chief Procurement Officer since 2003

Corporate responsibilities: Supply Management, Sustainability

Rick Harwig

1949, Dutch

Member of the GMC and Chief Technology Officer since April 2006

Corporate responsibilities: Technology Management, Research, Applied Technologies, Incubators, Intellectual Property & Standards, Molecular Diagnostics, PIC Bangalore

Hayko Kroese

1955, Dutch

Member of the GMC since February 2007; responsible for Human Resources Management since 2007

Corporate responsibilities: Human Resources Management

Gerard Ruizendaal

1958, Dutch

Member of the GMC since February 2007, Head of Control since October 2001 and Chief Strategy Officer since May 2005

Corporate responsibilities: Strategy and Control

Eric Coutinho

1951, Dutch

Member of the GMC since February 2007, Secretary to the Board of Management and Chief Legal Officer since May 2006

Corporate responsibilities: Legal, Company Secretary, Company Manual, General Business Principles

Maarten de Vries

1962, Dutch

Member of the GMC and Chief Information Officer since September 2007

Corporate responsibilities: Information Technology

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Supervisory Board

The Supervisory Board supervises the policies of the executive management (the Board of Management) and the general course of affairs of Philips and advises the executive management thereon. The Supervisory Board, in the two-tier corporate structure under Dutch law, is a separate and independent body from the Board of Management. The Rules of Procedure of the Supervisory Board are published on the Company s website.

Mr de Kleuver who joined the Supervisory Board in 1998, and has been Chairman since 2005, has expressed his wish to relinquish his position as a member of the Supervisory Board as from the closing of the 2008 Annual General Meeting of Shareholders. The Supervisory Board has appointed Mr Hessels as its Chairman as from the closing of the 2008 Annual General Meeting of Shareholders.

W. de Kleuver

1936, Dutch*****

Chairman

Member of the Supervisory Board since 1998; third term expires in 2010

Former Executive Vice-President of Royal Philips Electronics

L. Schweitzer

1942, French***

Vice-Chairman and Secretary

Member of the Supervisory Board since 1997; third term expires in 2009

Former CEO of Renault and Renault-Nissan BV. Chairman of the Board of Renault and AstraZeneca, Non-executive director of BNP Paribas, Electricité de France, Veolia Environnement, Volvo AB and L Oréal

Sir Richard Greenbury

1936, British**

Member of the Supervisory Board since 1998; third term expires in 2010

Former Chairman and CEO of Marks & Spencer and former Director of Lloyds TSB, British Gas, ICI, Zeneca and Electronics Boutique Plc.

J-M. Hessels

1942, Dutch*

Member of the Supervisory Board since 1999; third term expires in 2011

Former CEO of Royal Vendex KBB and currently Chairman of the Board of NYSE Euronext Inc, member of the Supervisory Boards of Heineken and Fortis and member of the International Advisory Board of Blackstone Group

Prof. K.A.L.M. van Miert

1942, Belgian*

Member of the Supervisory Board since 2000; second term expires in 2008

Former Vice-President of the European Commission and former President of Nyenrode University, member of the Supervisory Boards of RWE, Agfa Gevaert, De Persgroep, Munich Re, Anglo American, Vivendi Universal, Sibelco and Solvay and member of the Advisory Board of Goldman Sachs, Uni-Credto and FITCH

C.J.A. van Lede

1942, Dutch**

Member of the Supervisory Board since 2003; second term expires in 2011

Former Chairman of the Board of Management of Akzo Nobel and currently Chairman of the Supervisor Board of Heineken, temporary member of the Supervisory Board of Stork, non-executive member of the Boards of AirFrance/KLM, Sara Lee Corporation, Air Liquide, Chairman of the Board of Directors of INSEAD and Senior Advisor JP Morgan Plc

J.M. Thompson

1942, Canadian*****

Member of the Supervisory Board since 2003; second term expires in 2011

Former Vice-Chairman of the Board of Directors of IBM, and director of Hertz and Robert Mondavi; currently Chairman of the Board of Toronto Dominion Bank and a Director of Thomson Corporation

E. Kist

1944, Dutch*

Member of the Supervisory Board since 2004; first term expires in 2008

Former Chairman of the Executive Board of ING Group and currently member of the Supervisory Boards of the Dutch Central Bank, DSM, Moody s Investor Service and Stage Entertainment

Wong Ngit Liong

1941, Singaporean

Member of the Supervisory Board since 2005; first term expires in 2009

Chairman and CEO of the Venture Group of companies. Also a board member of DBS Bank and DBS Group Holdings Ltd, Chairman of the National University of Singapore Board of Trustee, and a member of the Research Innovation and Enterprise Council

J.J. Schiro

1946, American*

Member of the Supervisory Board since 2005; first term expires in 2009

CEO of Zurich Financial Services and Chairman of the Group Management Board. Also serves on various boards of private and listed companies including PepsiCo as Chairman of the Audit Committee and member of the Supervisory Board, Chairman of the Swiss American Chamber of Commerce

H. von Prondzynski

1949, German

Member of the Supervisory Board since 2007; first term expires in 2011

Former member of the Corporate Executive Committee of the F. Hofmann-La Roche Group and former CEO of the Division Diagnostics Roche and currently member of the Supervisory Board of Qiagen

Table of Contents

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

Report of the Supervisory Board

General

The supervision of the policies and actions of the executive management (the Board of Management) of Koninklijke Philips Electronics N.V. (the Company) is entrusted to the Supervisory Board, which, in the two-tier corporate structure under Dutch law, is a separate body and fully independent of the Board of Management. This independence is also reflected in the requirement that members of the Supervisory Board be neither a member of the Board of Management nor an employee of the Company. The Supervisory Board considers all its members to be independent under the applicable US standards and pursuant to the Dutch Corporate Governance Code of December 9, 2003 (the Dutch Corporate Governance Code). The Supervisory Board, acting in the interests of the Company and the Philips Group, supervises and advises the Board of Management in performing its management tasks and setting the direction of the Philips Group s business. It is empowered to recommend to the General Meeting of Shareholders persons to be appointed as members of the Supervisory Board or the Board of Management. Major management decisions, including the Philips Group strategy, require the approval of the Supervisory Board. The Supervisory Board further supervises the structure and management of systems of internal business controls and the financial reporting process. It determines the remuneration of the individual members of the Board of Management within the remuneration policy adopted by the General Meeting of Shareholders. While retaining overall responsibility, the Supervisory Board assigns certain of its tasks to three permanent committees: the Corporate Governance and Nomination & Selection Committee, the Remuneration Committee and the Audit Committee. The separate reports of these committees are part of this report and are published below. As in previous years, Philips addresses its overall corporate governance structure in the chapter Corporate governance that begins on page 250 of this Annual Report

Meetings and activities of the Supervisory Board

The Supervisory Board met 10 times in the course of 2007, including meetings by telephone conference; none of its members who were in office during the full year were frequently absent in these meetings. The members of the Board of Management were present at the meetings of the Supervisory Board except when they discussed the composition and functioning of the Board of Management and the Group Management Committee, as well as the remuneration and performance of individual members of the Board of Management and the Group Management Committee. Extensive evaluation of the functioning of the Supervisory Board and its members has taken place, resulting in several suggestions, which will be given further consideration. Furthermore, the training program for members of the Supervisory Board was continued and members of the Supervisory Board visited (head) offices of four divisions to further familiarize themselves with the business and the respective management teams. The Supervisory Board also spent two days in Shanghai where it discussed the Philips business in China and visited, amongst other locations, a lighting factory, shops where Philips products are sold and the Philips research center. An evaluation of the Board of Management and its members has also taken place, resulting in several suggestions. In addition to the scheduled meetings, the Chairman and other members of the Supervisory Board had regular contact with the President/Chief Executive Officer and other members of the Board of Management as well as senior executives of the Company throughout the year.

During the year the Supervisory Board again devoted considerable time to discussing the Company s strategy. In particular the integration of CE and DAP into the Consumer Lifestyle Sector and the growth targets for 2010 (Vision 2010) were discussed extensively.

98 Risk management | 112 Our leadership | 116 Report of the Supervisory Board | 126 Financial Statements

The Supervisory Board also discussed the capital structure of the Philips Group and approved the share repurchase program announced in 2007 as well as the sale of part of the Company s shares in TSMC and LG. Philips LCD. The Supervisory Board also evaluated opportunities for acquisitions and partnerships and approved several acquisitions, such as Color Kinetics, Genlyte and Respironics.

Other discussion topics included:

- financial performance of the Philips Group and the divisions
- status of merger and acquisition projects
- management agenda Board of Management
- remuneration policy
- management development and succession planning
- geographic performance and growth opportunities in Emerging Markets
- the Philips Group s annual budget 2008 and significant capital expenditures
- the situation at Philips Pension Fund in The Netherlands
- the investigations into possible anticompetitive activities in the CRT industry.

Composition and remuneration of the Supervisory Board

The Supervisory Board aims for an appropriate combination of knowledge and experience among its members in relation to the global and multi-product character of the Company s businesses. Consequently the Supervisory Board aims for an appropriate level of experience in marketing, technological, manufacturing, financial, economic, social and legal aspects of international business and government and public administration. The Supervisory Board further aims to have available appropriate experience within Philips by having one former Philips executive as a member. Members are appointed for fixed terms of four years and may be re-appointed for two additional four-year terms.

The Supervisory Board currently consists of eleven members, who are listed in the chapter Our leadership that begins on page 112 of this Annual Report. At the 2007 General Meeting of Shareholders Messrs Hessels, Van Lede and Thompson were re-appointed and Mr Von Prondzynski was elected to the Supervisory Board. At the 2008 General Meeting of Shareholders, the present term of Messrs Van Miert and Kist will end. The Supervisory Board very much welcomes the fact that these gentlemen, who have brought valuable experience and knowledge to our Board, are available for re-appointment. We shall make a proposal to the 2008 General Meeting of Shareholders to re-appoint Messrs Van Miert and Kist. Mr de Kleuver who joined the Supervisory Board in 1998, and has been Chairman since 2005, has expressed his wish to relinquish his position as a member of the Supervisory Board as from the closing of the 2008 Annual General Meeting of Shareholders. We wish to express our sincere appreciation for the way Mr de Kleuver has guided the Supervisory Board as its Chairman through the last three years and his valuable contributions to the Company during his ten-year term as a member of our Board. We wish him well for the future. The Supervisory Board has appointed Mr Hessels as its Chairman as from the closing of the 2008 Annual General Meeting of Shareholders. Mr Kist will succeed Mr Hessels as Chairman of the Audit Committee and Mr von Prondzynski will become a member of the Audit Committee as of the same date.

The remuneration of the members of the Supervisory Board and the additional remuneration for its Chairman and the members of its committees is determined by the General Meeting of Shareholders. The current fee structure for the Chairman and members of the Supervisory Board is EUR 75,000 per year for the Chairman and EUR 41,000 per year for members of the Supervisory Board. The annual remuneration for a regular member of a committee is EUR 4,500,

for the chairman of a committee EUR 6,000 and for

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors

the chairman of the Audit Committee EUR 7,000; details are disclosed in note 34.

Report of the Corporate Governance and Nomination & Selection Committee

The Corporate Governance and Nomination & Selection Committee currently consists of three members, who are listed in the chapter Our leadership. In line with the New York Stock Exchange listing rules and other developments in the field of corporate governance, the committee reviews the corporate governance principles applicable to the Company at least once a year, and advises the Supervisory Board on any changes to these principles as it deems appropriate. As in prior years, the committee discussed developments in the area of corporate governance and legislative changes as well as further steps the Company could take to improve its corporate governance structure. In view hereof, the Supervisory Board will propose to the 2008 General Meeting of Shareholders amendments to the current articles of association of the Company, which proposal together with explanatory notes is available on the Company s website (www.philips.com/investor). The proposal addresses legislative changes such as the implementation of the Dutch Act on Electronic Means of Communications and the Transparancy Directive and includes amendments with respect to the implementation of share repurchase programs as well as the remuneration of the members of the Supervisory Board.

In accordance with its charter, the Corporate Governance and Nomination & Selection Committee consulted in 2007 with the President/CEO and other members of the Board of Management on the appointment or re-appointment of candidates for Supervisory Board membership and candidates to fill current and future vacancies on the Board of Management and the Group Management Committee, prepared decisions and advised the Supervisory Board on the candidates for appointment, and supervised the policy of the Board of Management on the selection criteria and appointment procedures for Philips senior management.

At the 2007 General Meeting of Shareholders, Mr Kleisterlee was re-appointed as President/CEO, Mr Dutiné was re-appointed as member of Board of Management and Mr Rusckowski, CEO of the Medical Systems division, was appointed as member of Board of Management.

On September 10, 2007, the Company announced its plan to simplify its business structure by creating three core sectors: Philips Healthcare, Philips Ligthing and Philips Consumer Lifestyle and to integrate its Consumer Electronics and Domestic Appliances and Personal Care divisions into one Consumer Lifestyle sector as of January 1, 2008. Furthermore the Company also announced the combination of Consumer Healthcare Solutions, renamed as Home Healthcare Solutions, with Philips Medical Systems, under the new name of Philips Healthcare. In connection therewith, Mr Rusckowski became CEO of Philips Healthcare as per January 1, 2008. With effect from the same date, Mr Provoost, CEO of the Consumer Electronics division, has moved to the Philips Lighting sector, transitioning to take over as CEO from Mr van Deursen, who will retire on April 1, 2008. Mr Ragnetti, CEO of DAP, became CEO of the Consumer Lifestyle sector from January 1, 2008. We would like to thank Mr van Deursen for his significant contribution to Philips, in particular in the Company s lighting business.

In respect of the Group Management Committee, the following other changes occurred in 2007. On September 1, 2007, Mr de Vries was appointed as member of the Group Management Committee and succeeded Mr Hartert as Chief Information Officer who has been appointed CEO of the Imaging Systems business within the Medical Systems division.

Report of the Remuneration Committee

The Remuneration Committee, currently consisting of four members, who are listed in the chapter Our leadership, is responsible for preparing decisions of the Supervisory Board on the remuneration of individual members of the Board of Management and the Group Management Committee. It met five times in 2007. The Remuneration Committee proposes to the Supervisory Board the remuneration policy for members of the Board of Management and other members of the Group Management Committee, and reports annually to the Supervisory Board on the implementation of this remuneration policy. The Supervisory Board, through the Remuneration Committee, implements this policy and determines on the basis of this policy the remuneration of the individual members of the Board of Management and other members of the Group Management Committee. In performing its duties and responsibilities the Remuneration Committee is assisted by a remuneration expert acting on the basis of a protocol

ensuring that the expert acts on the instructions of the Remuneration Committee and on an independent basis in which conflicts of interest are avoided. The Remuneration Committee s tasks are laid down in the Charter of the Remuneration Committee that forms part of the Rules of Procedure of the Supervisory Board. Currently, no member of the Remuneration Committee is a member of the management board of another listed company.

General remuneration policy

The objective of the remuneration policy for members of the Board of Management, approved by the 2004 General Meeting of Shareholders, lastly amended by the 2007 General Meeting of Shareholders and published on the Company s website, is in line with that for Philips executives throughout the Philips Group: to focus on improving the performance of the Company and enhancing the value of the Philips Group, to motivate and retain them, and to be able to attract highly qualified executives, when required.

In order to link executive remuneration to the Company s performance, the remuneration package includes a significant variable part in the form of an annual cash incentive and a long-term incentive in the form of restricted share rights and stock options.

Contracts of employment

Members of the Board of Management have a contract of employment with the Company. The form of contract used for members of the Board of Management is in line with the standard form used for other Philips executives. As from August 1, 2003, for newly appointed members of the Board of Management and the other members of the Group Management Committee, the term of the contract is set at four years. In case the Company terminates the contract of employment, the maximum severance payment is in principle limited to one year of base salary in line with the Dutch Corporate Governance Code but subject to mandatory Dutch law, to the extent applicable. If the maximum of one year s salary would be manifestly unreasonable for a member of the Board of Management who is dismissed during his first term of office, the member of the Board of Management shall be eligible for a severance payment not exceeding twice the annual salary.

The contract of employment of the President/CEO was renewed as of April 1, 2007 for another 4 years. For the duration of the contract, the base salary is fixed at EUR 1,100,000. It was decided to grant an increased number of Long Term Incentives. No further accrual of pension entitlements will take place. The contract terms for current members of the Board of Management are presented in the table below.

Contract terms for current members[1)]

	end of term
G.J. Kleisterlee	April 1, 2011
P-J. Sivignon	June 15, 2009
G.H.A. Dutiné	April 1, 2011
T.W.H.P. van Deursen	April 1, 2008
R.S. Provoost	April 1, 2010
A. Ragnetti	April 1, 2010
S.H. Rusckowski	April 1, 2011

1) Reference date for board

membership is December 31, 2007

Base salary[1)]
in euros

	2005	2006	2007
G.J. Kleisterlee	1,020,000	1,042,500	1,087,500
P-J. Sivignon		568,750	637,500
G.H.A. Dutiné	511,000	540,750	587,500
T.W.H.P. van Deursen		412,500	587,500
R.S. Provoost		393,750	562,500
A. Ragnetti		356,250	531,250
S.H. Rusckowski			431,250

[1)] Annual review date is April 1, therefore amounts shown are partly (3 months) based on salary level before April 1 and partly (9 months) on salary level after April 1. Reference date for board membership is December 31, 2007.

In line with market developments shown by benchmark research and additional market studies, the salary levels in 2007 have been increased. The annual review date for the base salary is April 1. Information on the individual remuneration of the members of the Board of Management is shown in the table in note 34.

Annual Incentive

Each year, a variable cash incentive (Annual Incentive) can be earned, based on the achievement of specific and challenging targets.

The Annual Incentive criteria are for 80% the financial indicators of the Company and for 20% team targets in the areas of responsibility monitored by the individual members of the Board of Management. The related targets for the individual members of the Board of Management are determined annually at the beginning of the year by the Remuneration Committee on behalf

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

of the Supervisory Board. The (2007) financial targets (net income with a cash flow threshold and comparable sales growth, based on US GAAP) are determined upfront with measurable quantitative performance criteria and will not be adjusted during the year.

The on-target Annual Incentive percentage is set at 60% of the base salary for members of the Board of Management and 80% of the base salary for the President/CEO, and the maximum Annual Incentive achievable is 90% of the annual base salary and for the President/CEO 120% of the annual base salary. In exceptional circumstances, the Remuneration Committee may decide to increase this percentage by 20% (resulting in an Annual Incentive percentage of 108% for members and 144% for the President/CEO). The Annual Incentive pay-out in any year relates to the achievements of the preceding financial year in relation to agreed targets. As a result, Annual Incentives paid in 2007 relate to the salary levels and the performance in the year 2006. Similarly, the Annual Incentive payable in 2008 will be calculated on the basis of the 2007 annual results.

The Annual Incentive pay-out in 2007 and for the previous two years is shown in the next tables.

Pay-out in 2007[1)]

in euros

	realized annual incentive	as a % of base salary (2006)
G.J. Kleisterlee	1,186,618	113.0%
P-J. Sivignon	508,550	84.8%
G.H.A. Dutiné	513,691	93.4%
T.W.H.P. van Deursen	380,190	92.2%[2)]
R.S. Provoost	335,551	85.2%[2)]
A. Ragnetti	354,894	99.6%[2)]
S.H. Rusckowski		[3)]

1) Reference date for board membership is December 31, 2007

2) Pay-out related to period April 1 December 31, 2006

3) No pay-out related to period of board membership

Pay-out in 2006[1)]

in euros

	realized annual incentive	as a % of base salary (2005)

G.J. Kleisterlee	1,150,560	112.8%
P-J. Sivignon	219,191	84.6%[2]
G.H.A. Dutiné	433,998	84.6%
T.W.H.P. van Deursen		[3]
R.S. Provoost		[3]
A. Ragnetti		[3]

[1] Reference date for board membership is December 31, 2007

[2] Pay-out related to period June 15 December 31, 2005

[3] No pay-out related to period of board membership

Pay-out in 2005[1]
in euros

	realized annual incentive	as a % of base salary (2004)
G.J. Kleisterlee	1,028,160	100.8%
P-J. Sivignon		[2]
G.H.A. Dutiné	509,040	100.8%

[1] Reference date for board membership is December 31, 2007

[2] No pay-out in 2005 since Mr Sivignon joined Philips on June 15, 2005

Based upon the 2007 results as published in this Annual Report, the realized Annual Incentive amounts mentioned in the table below will be paid to members of the Board of Management in April 2008.

Pay-out in 2008[1]
in euros

	realized annual	as a % of base

	incentive	salary (2007)
G.J. Kleisterlee	490,512	44.6%
P-J. Sivignon	217,386	33.4%
G.H.A. Dutiné	200,664	33.4%
T.W.H.P. van Deursen	267,984	44.7%
R.S. Provoost	247,607	43.1%
A. Ragnetti	329,571	59.9%
S.H. Rusckowski	103,164	23.9%[2)]

1) Reference date for board membership is December 31, 2007

2) Pay-out related to period of board membership April 1 December 31, 2007

98 Risk management 112 Our leadership 116 Report of the Supervisory Board 126 Financial Statements

Long-Term Incentive Plan

For many years Philips has operated a Long-Term Incentive Plan (LTIP), which has served to align the interests of the participating employees with the shareholders interests and to attract, motivate and retain participating employees. Until 2002, the long-term incentive awards consisted exclusively of stock options, but since 2003 an LTIP approved by the General Meeting of Shareholders has been in place consisting of a mix of restricted share rights and stock options.

By granting additional (premium) shares after the grantees have held the restricted shares for three years after delivery, provided they are still in service, grantees will be more stimulated to focus on the longer term as shareholders of the Company.

The actual number of long-term incentives that will be granted to members of the Board of Management, the other members of the Group Management Committee, executives and other key employees depends on the team and/or individual performance and on the share performance of Philips and are aimed at median level of the relevant markets. As the value of the grants was below market median, the grant levels were increased in 2007.

The share performance of Philips is measured on the basis of the Philips Total Shareholder Return (TSR) compared to the TSR of a peer group of leading multinational electronics/electrical equipment companies over a three-year period. Since the sale of a majority stake in the Semiconductors division, the list of TSR peer group companies as approved in 2003 contained companies with which Philips did not compare itself any longer. The 2007 General Meeting of Shareholders approved a new list of peer group companies and a new simplified TSR-based LTI multiplier based on the ranking table below:

Philips position compared to peer companies[1)]	LTI Multiplier
Top 4	1.2
Middle 4	1.0
Bottom 4	0.8

[1)] Electrolux, Emerson Electric, General Electric, Hitachi, Honeywell International, Johnson & Johnson, Matsushita, Philips, Schneider Siemens, Toshiba, 3M

For 2007, the Supervisory Board has applied (under the old system) a multiplier of 1.1, based on the Philips share performance over the period from the last working day in December 2003 to December 31, 2006.

In 2007,7,270,713 stock options and 2,423,541 restricted share rights were granted under the LTIP (excluding the premium shares to be delivered after a three-year holding period); in 2006, 7,164,384 stock options and 2,466,189 restricted share rights were granted.

The 2006 General Meeting of Shareholders approved the amendment of the maximum allocation from 2.5% to 3.0% of the annual LTIP pool-size to members of the Board of Management.
Grants to members of the Board of Management under the LTIP:

Long-Term Incentive Plan 2007[1)2)]

	stock options	restricted share rights
GJ. KIeisterlee	73,926	24,642
P-J. Sivignon	42,903	14,301
G.H.A. Dutiné	39,600	13,200
T.W.H.P. van Deursen	39,600	13,200
R.S. Provoost	39,600	13,200
A. Ragnetti	39,600	13,200
S.H. Rusckowski	42,903	14,301

1) Reference date for board membership is December 31, 2007

2) Long-Term Incentive Multiplier of 1.1 applied

Long-Term Incentive Plan 2006[1)2)]

	stock options	restricted share rights
GJ. KIeisterlee	48,006	16,002
P-J. Sivignon	33,003	11,001
G.H.A. Dutiné	30,006	10,002
T.W.H.P. van Deursen	30,006	10,002
R.S. Provoost	30,006	10,002
A. Ragnetti	27,000	9,000

1) Reference date for board membership is December 31, 2007

2) Long-Term Incentive Multiplier of 1.0 applied

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

Long-Term Incentive Plan 2005[1)2)]

	stock options	restricted share rights
G.J. KIeisterlee	48,006	16,002
P-J. Sivignon	32,004	10,668
G.H.A. Dutiné	32,004	10,668

1) Reference date for board membership is December 31, 2007

2) Long-Term Incentive Multiplier of 1.0 applied

For more details of the LTIP, see note 33.

According to Philips Rules of Conduct with respect to inside information, members of the Board of Management (and the other members of the Group Management Committee) are only allowed to trade in Philips securities (including the exercise of stock options) during windows of ten business days following the publication of annual and quarterly results (provided the person involved has no inside information regarding Philips at that time) unless an exemption is available.

To further align the interests of the members of the Board of Management and shareholders, restricted shares granted to the Board of Management members shall be retained for a period of at least five years or until at least the end of their employment, if this period is shorter. Similarly for other Philips Senior Executives compulsory share ownership was introduced in 2004.

Total cash pay-out

The total cash pay-out in any year is the sum of the base salary received in the year concerned and the bonus pay-out related to the previous year. The total cash pay-out in 2007 (and in previous two years) for each member of the Board of Management is presented in the next table.

Total cash pay-out[1)]

in euros

	2005	2006	2007
G.J. KIeisterlee	2,048,160	2,543,060[3)]	2,274,118
P-J. Sivignon	259,091[2)]	1,087,941[3)]	1,146,050
G.H.A. Dutiné	1,020,040	974,748	1,101,191
T.W.H.P. van Deursen	[4)]	412,500[5)]	967,690
R.S. Provoost	[4)]	393,750[5)]	898,051
A. Ragnetti	[4)]	356,250[5)]	886,144
S.H. Rusckowski	[6)]	[6)]	431,250[7)]

1)

Reference date for board membership is December 31, 2007

2) Related to period June 15 December 31, 2005

3) Including a special payment for the sale of the Semiconductors division

4) Before date of appointment as member of the Board of Management (April 1, 2006)

5) Related to period April 1 December 31, 2006

6) Before date of appointment as member of the Board of Management (April 1, 2007)

7) Related to period April 1 December 31, 2007

Percentage variable remuneration

The variable performance-based reward part of the members of the Board of Management is presented in the table below.

Variable remuneration as % of total remuneration[1)2)]

	2005	2006	2007
G.J. Kleisterlee	62.1%	65.7%	70.2%
P-J. Sivignon		58.4%	67.2%
G.H.A. Dutiné	64.8%	64.0%	68.0%
T.W.H.P. van Deursen		3)	65.5%

R.S. Provoost	3)	65.6%
A. Ragnetti	3)	67.2%
S.H. Rusckowski		**3)**

1) Reference date for board membership is December 31, 2007

2) Restricted shares based upon actual grant price and stock options based upon Black-Scholes value of the actual grant price in a particular year (see note 33 share-based compensation)

3) Due to incomplete year as member of the Board of Management, no variable remuneration related to Board of Management period is mentioned

98 Risk management | 112 Our leadership | 116 Report of the Supervisory Board | 126 Financial Statements

Pensions

As of January 1, 2006, a new pension plan is in force for all Philips executives in the Dutch pension fund born after January 1, 1950. This includes members of the Board of Management and other members of the Group Management Committee. The new plan is based on a combination of defined-benefit (career average) and defined-contribution and replaces the previous final pay plan. The target retirement age under the new plan is 62.5. The plan does not require employee contributions. Messrs Kleisterlee and Van Deursen continued to participate in the old plan till they reached the age of 60. Since then no further accrual took place under this plan.

Additional arrangements

In addition to the main conditions of employment, a number of additional arrangements apply to members of the Board of Management. These additional arrangements, such as expense and relocation allowances, medical insurance, accident insurance and company car arrangements, are broadly in line with those for Philips executives in the Netherlands. In the event of disablement, members of the Board of Management are entitled to benefits in line with those for other Philips executives in the Netherlands.

In line with regulatory requirements, the Company s policy forbids personal loans to members of the Board of Management as well as to other members of the Group Management Committee, and consequently no loans were granted to such members in 2007, nor were such loans outstanding as of December 31, 2007.

Unless the law provides otherwise, the members of the Board of Management and of the Supervisory Board shall be reimbursed by the Company for various costs and expenses, like reasonable costs of defending claims, as formalized in the articles of association. Under certain circumstances, described in the articles of association, such as an act or failure to act by a member of the Board of Management or a member of the Supervisory Board that can be characterized as intentional (opzettelijk), intentionally reckless (bewust roekeloos) or seriously culpable (ernstig verwijtbaar), there will be no entitlement to this reimbursement. The Company has also taken out liability insurance (D&O - Directors & Officers) for the persons concerned.

Outlook 2008

Based on the trends in the market (European General Industry), the Supervisory Board proposes to amend the remuneration policy for members of Board of Management as follows.

Annual Incentive on-target levels are determined as a percentage of base salary. The current maximum pay-out structure under the plan shall be replaced by a simplified maximum equal to twice the on-target Annual Incentive levels. For the Board of Management the consequences of this change are reflected below.

Annual Incentive

	On-target (as % of base salary)	Current maximum	Proposed maximum
CEO	80%	144%	160%
BoM member	60%	108%	120%

The 2008 Annual Incentive criteria are i) net income, cash flow and comparable sales growth and ii) team targets.

It is proposed to determine the restricted share grant levels in accordance with a multiplier of zero to 2. The current plan has limited downside and equally upside. With the range of the new proposed multiplier, the restricted share right grants will be better aligned with Philips relative TSR performance.

Proposed TSR

TSR Ranking	**1**	**2**	**3**	**4**	**5**	**6**
Multiplier (current)	1.2	1.2	1.2	1.2	1	1
Multiplier (proposed)	2	1.8	1.6	1.4	1.2	1

Proposed TSR

TSR Ranking	**7**	**8**	**9**	**10**	**11**	**12**
Multiplier (current)	1	1	0.8	0.8	0.8	0.8
Multiplier (proposed)	1	0.8	0.6	0.4	0.2	0

As stock options are intrinsically performance related, it will be proposed that grant levels for stock options are no longer determined in accordance with the TSR-multiplier of 0.8 1.2. The intrinsic performance condition lies in the fact that the share price upon exercise must exceed the share price upon grant (exercise price) in order to provide a value to the grantee.

8 Financial highlights | 10 Message from the President | 16 The Philips Group | 62 The Philips sectors

The proposed changes to the plan can be accommodated within the current pool size of maximum 17.5 million shares. The actual number of stock options and restricted share rights that will be granted in any particular year will be determined by the Supervisory Board in accordance with the terms and conditions of the LTIP.

As the base fee for the Supervisory Board has not been changed since 1998, a proposal shall be made to the 2008 General Meeting of Shareholders to adjust the fee structure for the chairman and members of the Supervisory Board with effect from January 1, 2008.

The above-mentioned proposals will be submitted to the 2008 General Meeting of Shareholders for approval.

Report of the Audit Committee

The Audit Committee, currently consisting of four members of the Supervisory Board, who are listed in the chapter Our leadership, assists the Supervisory Board in fulfilling its supervisory responsibilities for the integrity of the Company s financial statements, the financial reporting process, the system of internal business controls and risk management, the internal and external audit process, the internal and external auditor s qualifications, independence and performance, as well as the Company s process for monitoring compliance with laws and regulations and the General Business Principles (GBP).

The Audit Committee met 10 times in 2007 and reported its findings periodically to the plenary Supervisory Board. The President, the Chief Financial Officer, the Internal Auditor, the Group Controller and the External Auditor attended all regular meetings. Furthermore, the Audit Committee met each quarter separately with each of the President, the Chief Financial Officer, the Internal Auditor and the External Auditor. In accordance with its charter, which is part of the Rules of Procedure of the Supervisory Board, the Audit Committee in 2007 reviewed the Company s annual and interim financial statements, including non-financial information, prior to publication thereof. It also assessed in its quarterly meetings the adequacy and appropriateness of internal control policies and internal audit programs and their findings.

In its 2007 meetings, the Audit Committee reviewed periodically matters relating to accounting policies and compliance with accounting standards. Compliance with statutory and legal requirements and regulations, particularly in the financial domain, was also reviewed. Important findings and identified risks were examined thoroughly in order to allow appropriate measures to be taken. With regard to the internal audit, the Audit Committee reviewed, and if required approved, the internal audit charter, audit plan, audit scope and its coverage in relation to the scope of the external audit, as well as the staffing, independence and organizational structure of the internal audit function. With regard to the external audit, the Audit Committee reviewed the proposed audit scope, approach and fees, the independence of the external auditors, non-audit services provided by the external auditors in conformity with the Philips Policy on Auditor Independence, as well as any changes to this policy. Within the framework of the Philips policy on auditor independence, the evaluation of the performance of the external auditor takes place every three years and the Audit Committee has discussed the detailed evaluation report and has presented the conclusions to the Supervisory Board. After assessing the performance of the external auditors in accordance with the Philips Policy on Auditor Independence, the Audit Committee has advised the Supervisory Board to propose to the General Meeting of Shareholders to re-appoint KPMG Accountants N.V. for another three-year term. The Audit Committee also considered the report of the external auditors with respect to the annual financial statements and advised on the Supervisory Board s statement to shareholders in the annual accounts.

The aggregate fees billed by KPMG for professional services rendered for the fiscal years 2005, 2006 and 2007 were as follows:

Aggregate fees KPMG

in millions of euros

	2005	2006	2007
Audit fees	14.4	20.6	17.6
Audit-related fees	5.0	9.8	3.9
Tax fees	1.3	0.9	1.2

Other fees	2.9	2.4	2.3
	23.6	33.7	25.0

Audit fees consist of fees for the examination of both the consolidated financial statements (EUR 7.2 million) and statutory financial statements (EUR 4.7 million), as well as the audit of internal controls over financial reporting (EUR 5.7 million). Audit-related fees consist of fees in connection with audits of acquisitions and divestments (EUR 2.3 million) and other audit-related fees (EUR 1.6 million). Tax fees (EUR 1.2 million) mainly relate to tax compliance and expatriate tax services. Other fees comprise royalty audit fees (EUR 1.9 million) and sustainability and other services (EUR 0.4 million).

In 2007, the Audit Committee further periodically discussed the Company s policy on business controls, the GBP including the deployment thereof, and the Company s major areas of risk, including the internal auditor s reporting thereon. The Audit Committee was informed on, discussed and monitored closely the Company s internal control certification processess, in particular compliance with section 404 of the US Sarbanes-Oxley Act and its requirements regarding assessment, review and monitoring of internal controls. It also discussed tax issues, litigation (including asbestos) and related provisions, environmental exposures and financial exposures in the area of treasury, dividend, pensions (including the situation at Philips Pension Fund in The Netherlands), accounting treatment of share repurchases, financial holdings, the sale of shared service centers, the investigations into possible anticompetitive activities in the CRT industry and MedQuist, as well as a financial evaluation of the investments made in 2004.

Financial statements 2007

The financial statements of Koninklijke Philips Electronics N.V. for 2007, as presented by the Board of Management, have been audited by KPMG Accountants N.V., independent auditors. Their reports have been included in the chapter IFRS financial statements on page 239 and the chapter Company financial statements on page 245 of this Annual Report. We have approved these financial statements, and all individual members of the Supervisory Board (together with the members of the Board of Management) have signed these documents.

We recommend to shareholders that they adopt the 2007 financial statements. We likewise recommend to shareholders that they adopt the proposal of the Board of Management to pay a dividend of EUR 0.70 per common share.

Finally, we would like to express our thanks to the members of the Board of Management, the Group Management Committee and all other employees for their continued contribution during the year.

February 18, 2008

The Supervisory Board

Table of Contents

8 Financial highlights 10 Message from the President 16 The Philips Group 62 The Philips sectors
Financial statements

Group financial statements
128 Management s report
129 Auditors report
130 Consolidated statements of income
132 Consolidated balance sheets
134 Consolidated statements of cash flows
136 Consolidated statements of stockholders equity
137 Information by sectors and main countries
140 Significant accounting policies
146 Notes to the Group financial statements

IFRS financial statements
189 IFRS management commentary
194 Consolidated statements of income
196 Consolidated balance sheets
198 Consolidated statements of cash flows
200 Consolidated statements of equity
202 Information by sectors and main countries
205 Significant IFRS accounting policies
211 Notes to the IFRS financial statements
239 Auditor s report

Company financial statements
240 Balance sheets
241 Statements of income
241 Statement of equity
243 Notes to the Company financial statements
245 Auditor s report

246 Reconciliation of non-US GAAP information

250 Corporate governance

258 The Philips Group in the last ten years

260 Investor information

		Notes to the group financial statements
146	**1**	Discontinued operations
147	**2**	Acquisitions and divestments
152	**3**	Income from operations
153	**4**	Restructuring charges
155	**5**	Financial income and expenses
155	**6**	Income taxes
157	**7**	Investments in equity-accounted investees
159	**8**	Earnings per share
159	**9**	Receivables
159	**10**	Inventories
159	**11**	Other current assets
160	**12**	Other non-current financial assets
160	**13**	Non-current receivables
160	**14**	Other non-current assets
161	**15**	Property, plant and equipment
162	**16**	Intangible assets excluding goodwill
162	**17**	Goodwill
163	**18**	Accrued liabilities
163	**19**	Provisions
164	**20**	Pensions
168	**21**	Postretirement benefits other than pensions
171	**22**	Other current liabilities
171	**23**	Short-term debt
172	**24**	Long-term debt
173	**25**	Other non-current liabilities
173	**26**	Contractual obligations
173	**27**	Contingent liabilities
176	**28**	Stockholders equity
176	**29**	Cash from derivatives
176	**30**	Proceeds other non-current financial assets
176	**31**	Assets in lieu of cash from sale businesses
177	**32**	Related-party transactions
177	**33**	Share-based compensation
180	**34**	Information on remuneration
184	**35**	Fair value of financial assets and liabilities
185	**36**	Other financial instruments
185	**37**	Subsequent events
		Notes to the IFRS financial statements
211	**38**	Discontinued operations
212	**39**	Acquisitions and divestments
217	**40**	Income from operations
218	**41**	Financial income and expenses
219	**42**	Income taxes
221	**43**	Investments in equity-accounted investees

224	**44**	Earnings per share
224	**45**	Receivables
225	**46**	Inventories
225	**47**	Other current assets
225	**48**	Other non-current financial assets
225	**49**	Non-current receivables
225	**50**	Other non-current assets
226	**51**	Property, plant and equipment
227	**52**	Intangible assets excluding goodwill
227	**53**	Goodwill
228	**54**	Accrued liabilities
228	**55**	Provisions
228	**56**	Pensions and postretirement benefits
231	**57**	Other current liabilities
232	**58**	Short-term debt
232	**59**	Long-term debt
233	**60**	Other non-current liabilities
233	**61**	Contractual obligations
234	**62**	Contingent liabilities
236	**63**	Stockholders equity
237	**64**	Cash from derivatives
237	**65**	Proceeds other non-current financial assets
237	**66**	Assets in lieu of cash from sale businesses
237	**67**	Related-party transactions
237	**68**	Fair value of financial assets and liabilities
237	**69**	Other financial instruments
238	**70**	Subsequent events
		Notes to the company financial statements
243	**A**	Receivables
243	**B**	Investments in affiliated companies
243	**C**	Other non-current financial assets
243	**D**	Other current liabilities
243	**E**	Short-term debt
243	**F**	Provisions
244	**G**	Long-term debt
244	**H**	Stockholders equity
244	**I**	Net income
244	**J**	Employees
245	**K**	Obligations not appearing in the balance sheet
245	**L**	Subsequent events

Management s report on internal control over financial reporting pursuant to section 404 of the US Sarbanes-Oxley Act

The Board of Management of Koninklijke Philips Electronics N.V. (the Company) is responsible for establishing and maintaining an adequate system of internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the US Securities Exchange Act). Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America (US GAAP).

Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

The Board of Management conducted an assessment of the Company s internal control over financial reporting based on the *Internal Control-Integrated Framework* established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, the Board of Management concluded that, as of December 31, 2007, the Company s internal control over US GAAP financial reporting is considered effective.

The Board of Management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2007, excluded the following companies acquired by the Company after January 1, 2007: Health Watch, Raytel Cardiac Services, VMI Sistemas Medicos, XIMIS, Emergin, Color Kinetics, TIR Systems, Partners in Lighting International, Lighting Technologies International and Digital Lifestyle Outfitters. These acquisitions are wholly-owned subsidiaries of the Company of which total assets represented 4.3% of consolidated total assets and net sales represented less than 2% of consolidated net sales of the Company as of and for the year ended December 31, 2007. If adequately disclosed, companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition while integrating the acquired company under guidelines established by the US Securities and Exchange Commission.

The effectiveness of the Company s internal control over US GAAP financial reporting as of December 31, 2007, as included in this chapter Group financial statements, has been audited by KPMG Accountants N.V., an independent registered public accounting firm, as stated in their report which follows hereafter.

Board of Management

February 18, 2008

Table of Contents

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Report of independent registered public accounting firm

To the Supervisory Board and Shareholders of Koninklijke Philips Electronics N.V.:

We have audited the accompanying consolidated balance sheets of Koninklijke Philips Electronics N.V. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2007, appearing on page 130 to 186. We also have audited Koninklijke Philips Electronics N.V. and subsidiaries internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Koninklijke Philips Electronics N.V. and subsidiaries management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting appearing on page 128. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Koninklijke Philips Electronics N.V. and subsidiaries acquired Health Watch, Raytel Cardiac Services, VMI Sistemas Medicos, XIMIS, Emergin, Color Kinetics, TIR Systems, Partners in Lighting International, Lighting Technologies International and Digital Lifestyle Outfitters (together the Acquired Companies) during 2007. Management excluded from its assessment of the effectiveness of Koninklijke Philips Electronics N.V. and subsidiaries internal control over financial reporting as of December 31, 2007, the Acquired Companies internal control over financial reporting of which total assets represented 4.3% of consolidated total assets and net sales represented less than 2% of consolidated net sales included in the consolidated financial statements of Koninklijke Philips Electronics N.V. and subsidiaries as of and for the year ended December 31, 2007. Our audit of internal control over financial reporting of Koninklijke

Philips Electronics N.V. and subsidiaries also excluded an evaluation of the internal control over financial reporting of the Acquired Companies.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Koninklijke Philips Electronics N.V. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Koninklijke Philips Electronics N.V. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in note 20 to the consolidated financial statements, effective December 31, 2006, Koninklijke Philips Electronics N.V. and subsidiaries adopted the provisions of SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans .

KPMG Accountants N.V.

Amstelveen, February 18, 2008

Table of Contents

Consolidated statements of income

Consolidated statements of income of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

		2005	2006	2007
	Sales	25,445	26,682	26,793
	Cost of sales	(17,498)	(18,432)	(17,624)
	Gross margin	7,947	8,250	9,169
	Selling expenses	(4,439)	(4,655)	(4,980)
	General and administrative expenses	(774)	(969)	(854)
	Research and development expenses	(1,593)	(1,659)	(1,629)
	Other business income	417	234	146
3 4	Income from operations	1,558	1,201	1,852
5	Financial income and expenses	104	28	2,613
	Income before taxes	1,662	1,229	4,465
6	Income tax expense	(526)	(167)	(622)
	Income after taxes	1,136	1,062	3,843
7	Results relating to equity-accounted investees	1,754	(157)	763
	Minority interests	(11)	(4)	(5)
	Income from continuing operations	2,879	901	4,601
1	Discontinued operations	(11)	4,482	(433)
8	Net income	2,868	5,383	4,168

The years 2005 and 2006 are restated to present the MedQuist business as a discontinued operation.

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

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Earnings per share

	2005	2006	2007
Weighted average number of common shares outstanding (after deduction of treasury stock) during the year (in thousands)	1,249,956	1,174,925	1,086,128
Adjusted weighted average number of shares (after deduction of treasury stock) during the year (in thousands)	1,253,330	1,182,784	1,097,435
Basic earnings per common share in euros			
Income from continuing operations	2.30	0.77	4.24
Income (loss) from discontinued operations	(0.01)	3.81	(0.40)
Net income	2.29	4.58	3.84
Diluted earnings per common share in euros			
Income from continuing operations	2.30	0.76	4.19
Income (loss) from discontinued operations	(0.01)	3.79	(0.39)
Net income	2.29	4.55	3.80
Dividend paid per common share in euros	0.40	0.44	0.60

Consolidated balance sheets

Consolidated balance sheets of the Philips Group as of December 31

in millions of euros unless otherwise stated

Assets

			2006		2007
	Current assets				
	Cash and cash equivalents		5,886		8,769
9 32	Receivables:				
	- Accounts receivable net	4,257		4,209	
	- Accounts receivable from related parties	37		26	
	- Other receivables	438		435	
			4,732		4,670
1	Current assets of discontinued operations		206		169
10	Inventories net		2,880		3,203
11	Other current assets		1,258		1,020
	Total current assets		14,962		17,831
	Non-current assets				
7	Investments in equity-accounted investees		2,974		1,886
12	Other non-current financial assets		8,055		3,183
13	Non-current receivables		214		84
1	Non-current assets of discontinued operations		225		164
14	Other non-current assets		3,447		3,726
15 26	Property, plant and equipment:				
	- At cost	7,524		7,874	
	- Less accumulated depreciation	(4,440)		(4,694)	
			3,084		3,180
16	Intangible assets excluding goodwill:				
	- At cost	2,751		3,244	
	- Less accumulated amortization	(938)		(1,090)	
			1,813		2,154
17	Goodwill		3,723		4,135

Total non-current assets	23,535	18,512
	38,497	36,343

The year 2006 is restated to present the MedQuist business as a discontinued operation.
The accompanying notes are an integral part of these consolidated financial statements.

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Liabilities and stockholders equity

			2006		2007
	Current liabilities				
32	Accounts and notes payable:				
	- Trade creditors	3,172		3,083	
	- Accounts payable to related parties	271		289	
			3,443		3,372
1	Current liabilities of discontinued operations		46		46
18	Accrued liabilities		3,297		2,984
19 20 21 27	Short-term provisions		876		377
22	Other current liabilities		605		509
23 24	Short-term debt		863		2,345
	Total current liabilities		9,130		9,633
	Non-current liabilities				
24 26	Long-term debt		3,006		1,212
19 20 21 27	Long-term provisions		2,417		2,727
1	Non-current liabilities and minority interests of discontinued operations		123		111
25	Other non-current liabilities		784		934
	Total non-current liabilities		6,330		4,984
26 27	Contractual obligations and contingent liabilities				
	Minority interests		40		42
28	Stockholders equity:				
	Preference shares, par value EUR 0.20 per share				
	- Authorized: 2,500,000,000 shares (2006: 2,500,000,000 shares)				
	- Issued: none				
	Common shares, par value EUR 0.20 per share:				
	- Authorized: 2,500,000,000 shares (2006: 2,500,000,000 shares)				
	- Issued and fully paid: 1,142,826,763 shares (2006: 1,142,826,763 shares)	228		228	
	Capital in excess of par value				
	Retained earnings	22,085		25,559	

Accumulated other comprehensive income (loss)	1,607		(1,887)	
Treasury shares, at cost 77,933,509 shares (2006: 35,933,526 shares)	(923)		(2,216)	
		22,997		21,684
		38,497		36,343

Consolidated statements of cash flows

Consolidated statements of cash flows of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

		2005	2006	2007
	Cash flows from operating activities			
	Net income	2,868	5,383	4,168
	Loss (income) from discontinued operations	11	(4,482)	433
	Adjustments to reconcile net income to net cash provided by operating activities:			
	Depreciation and amortization	713	810	851
	Impairment of equity-accounted investees and available-for-sale securities	427	8	39
	Net gain on sale of assets	(2,104)	(289)	(3,159)
	(Income) loss from equity-accounted investees	(636)	228	(249)
	Dividends received from equity-accounted investees	312		48
	Minority interests (net of dividends paid)	29	3	5
	Increase in receivables and other current assets	(182)	(1,354)	(439)
	(Increase) decrease in inventories	(235)	2	(389)
	Increase (decrease) in accounts payable, accrued and other liabilities	302	(20)	186
	Increase in non-current receivables/other assets	(250)	(55)	(143)
	(Decrease) increase in provisions	(140)	83	(65)
	Proceeds from sales of trading securities			196
	Other items	32	13	37
	Net cash provided by operating activities	1,147	330	1,519
	Cash flows from investing activities			
	Purchase of intangible assets	(74)	(101)	(118)
	Capital expenditures on property, plant and equipment	(637)	(694)	(661)
	Proceeds from disposals of property, plant and equipment	212	107	81
29	Cash from (to) derivatives	(46)	62	385
	Purchase of other non-current financial assets	(18)	(31)	(17)
30	Proceeds from other non-current financial assets	630	4	4,105
	Purchase of businesses, net of cash acquired	(1,089)	(2,467)	(1,485)
	Proceeds from sale of interests in businesses	2,716	318	1,640
	Net cash provided by (used for) investing activities	1,694	(2,802)	3,930
	Cash flows from financing activities			
	(Decrease) increase in short-term debt	(36)	97	(158)
	Principal payments on long-term debt	(362)	(543)	(152)
	Proceeds from issuance of long-term debt	74	9	29
	Treasury stock transactions	(1,761)	(2,755)	(1,448)
	Dividends paid	(504)	(523)	(639)
	Net cash used for financing activities	(2,589)	(3,715)	(2,368)
	Net cash provided by (used for) continuing operations	252	(6,187)	3,081

Cash flows from discontinued operations			
Net cash provided by (used for) operating activities	942	524	(153)
Net cash (used for) provided by investing activities	(409)	6,590	38
Net cash provided by (used for) financing activities			
Net cash provided by (used for) discontinued operations	533	7,114	(115)
Net cash provided by continuing and discontinued operations	785	927	2,966
Effect of changes in exchange rates on cash positions	159	(197)	(112)
Cash and cash equivalents at the beginning of the year	4,349	5,293	6,023
Cash and cash equivalents at the end of the year	5,293	6,023	8,877
Less cash and cash equivalents at the end of the year discontinued operations	150	137	108
Cash and cash equivalents at the end of the year continuing operations	5,143	5,886	8,769

The years 2005 and 2006 are restated to present the MedQuist business as a discontinued operation.

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

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Supplemental disclosures to the consolidated statements of cash flows

		2005	2006	2007
	Net cash paid during the year for			
	Interest	178	211	49
	Income taxes	302	632	493
	Net gain on sale of assets			
	Cash proceeds from the sale of assets	3,558	429	5,826
	Book value of these assets	(1,390)	(193)	(2,765)
	Deferred results on sale-and-leaseback transactions	21	27	11
	Non-cash gains (losses)	(85)	26	87
		2,104	289	3,159
	Non-cash investing and financing information			
31	Assets received in lieu of cash from the sale of businesses:			
	- Shares/share options/convertible bonds	308	188	
	- Receivables/loans		6	
	Conversion of convertible personnel debentures		26	38
	Treasury stock transactions			
	Shares acquired	(1,836)	(2,899)	(1,609)
	Exercise of stock options	75	145	161

The years 2005 and 2006 are restated to present the MedQuist business as discontinued operation.
The accompanying notes are an integral part of these consolidated financial statements.
For a number of reasons, principally the effects of translation differences and consolidation changes, certain items in the statements of cash flows do not correspond to the differences between the balance sheet amounts for the respective items.

Consolidated statements of changes in stockholders equity of the Philips Group

in millions of euros unless otherwise stated

					accumulated other comprehensive income (loss)							
	outstanding number of shares in thousands	common stock	capital in excess of par value	retained earnings	currency translation differences	unrealized gain (loss) on available-for-sale securities	additional minimum pension liability	pensions (SFAS No. 158)	change in fair value of cash flow hedges	total	treasury shares at cost	total stockholders equity
Balance as of Dec. 31, 2004	1,281,527	263	97	19,346	(3,407)	174	(429)		55	(3,607)	(1,239)	14,860
Conversion of priority shares into common stock	25											
Net income				2,868								2,868
Net current period change					1,137	43	(181)		(96)	903		903
Income tax on net current period change					49		65		32	146		146
Reclassifications into income					335	(227)			(20)	88		88
Total comprehensive income (loss), net of tax				2,868	1,521	(184)	(116)		(84)	1,137		4,005
Dividend paid				(504)								(504)
Purchase of treasury stock	(83,823)										(1,836)	(1,836)
Re-issuance of treasury stock	3,629		(85)								156	71
Share-based compensation plans			70									70
Balance as of Dec. 31, 2005	1,201,358	263	82	21,710	(1,886)	(10)	(545)		(29)	(2,470)	(2,919)	16,666

Net income				5,383								5,383
Net current period change					(304)	4,389	298		72	4,455		4,455
Income tax on net current period change					(72)		(84)		(15)	(171)		(171)
Reclassifications into income					388	(98)			(20)	270		270
Total comprehensive income net of tax				5,383	12	4,291	214		37	4,554		9,937
Adoption of SFAS No. 158							331	(808)		(477)		(477)
Cancellation of treasury shares		(35)		(4,332)							4,367	
Dividend paid				(523)								(523)
Purchase of treasury stock	(105,949)										(2,899)	(2,899)
Re-issuance of treasury stock	11,484		(204)	(153)							528	171
Share-based compensation plans			122									122
Balance as of Dec. 31, 2006	1,106,893	228		22,085	(1,874)	4,281		(808)	8	1,607	(923)	22,997
Net income				4,168								4,168
Net current period change					(830)	(618)		223	19	(1,206)		(1,206)
Income tax on net current period change					(10)			(56)	(3)	(69)		(69)
Reclassifications into income					341	(2,615)		51	4	(2,219)		(2,219)
Total comprehensive income net of tax				4,168	(499)	(3,233)		218	20	(3,494)		674
Dividend paid				(659)								(659)
Purchase of treasury stock	(53,141)										(1,633)	(1,633)
Re-issuance of treasury stock	11,141		(106)	(35)							340	199
Share-based compensation plans			104									104
Income tax share-based compensation			2									2

plans										
Balance as of Dec. 31, 2007	1,064,893	228	25,559	(2,373)	1,048	(590)	28	(1,887)	(2,216)	21,684

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

246 Reconciliation of non-US GAAP information
250 Corporate governance
258 The Philips Group in the last ten years
260 Investor information

Information by sectors and main countries

in millions of euros unless otherwise stated

Sectors

	sales	research and development expenses	income from operations	income from operations as a % of sales	results relating to equity-accounted investees	cash flow before financing activities
2007						
Medical Systems	6,470	(584)	743	11.5	7	420
DAP	2,968	(171)	510	17.2		415
Consumer Electronics	10,362	(321)	322	3.1	2	357
Lighting	6,093	(276)	675	11.1		(648)
Innovation & Emerging Businesses	703	(598)	(101)	(14.4)	(9)	(348)
Group Management & Services	197		(297)		763	5,253
Inter-sector eliminations		321				
	26,793	(1,629)	1,852	6.9	763	5,449
2006						
Medical Systems	6,448	(566)	734	11.4	9	(427)
DAP	2,532	(168)	370	14.6		(287)
Consumer Electronics	10,576	(385)	313	3.0	3	248
Lighting	5,466	(269)	577	10.6	(4)	451
Innovation & Emerging Businesses	1,493	(577)	(94)	(6.3)	(12)	(625)
Group Management & Services	167		(699)		(153)	(1,832)
Inter-sector eliminations		306				
	26,682	(1,659)	1,201	4.5	(157)	(2,472)
2005						
Medical Systems	6,013	(517)	688	11.4	10	505
DAP	2,194	(139)	324	14.8		384
Consumer Electronics	10,422	(419)	404	3.9	2	548
Lighting	4,775	(212)	499	10.5	18	(236)
Innovation & Emerging Businesses	1,905	(587)	(165)	(8.7)	(8)	(96)
Group Management & Services	136		(192)		1,732	1,736
Inter-sector eliminations		281				
	25,445	(1,593)	1,558	6.1	1,754	2,841

The years 2005 and 2006 have been restated to present the MedQuist business as a discontinued operation. 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, 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.

The following sectors are distinguished as reportable segments: Medical Systems, Domestic Appliances and Personal Care (DAP), Consumer Electronics (CE), Lighting, Innovative & Emerging Businesses (I&EB) and Group Management & Services (GMS). A short description of these sectors is as follows:

Medical Systems: Supplier of Imaging Systems, Ultrasound & Monitoring systems, Healthcare Informatics and Customer Services.

DAP: Markets a wide range of products in the areas of Shaving & Beauty, Domestic Appliances, Health & Wellness and Oral Healthcare.

CE: Provider of Connected Displays, Entertainment Solutions, Peripherals & Accessories, Home Networks and Optical Licenses.

Lighting: Consists of the following lines of business Lamps, Luminaires, Lighting Electronics, Automotive, Special Lighting & UHP and Lumileds.

I&EB: Comprises various activities and businesses not belonging to a specific sector. It consists of Corporate Technologies (such as Research, Intellectual Property & Standards, Applied Technologies and the Healthcare, Lifestyle and Technology Incubators), Corporate Investments and Other.

GMS: Includes overhead expenses in the corporate center and the cost of regional and country organizations. Also included are the costs of Philips global brand campaign and pension and other postretiremen! benefit costs not directly allocated to the other sectors.

Table of Contents

Information by sectors and main countries

Sectors

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation of property, plant and equipment
2007						
Medical Systems	6,033	4,104	1,877	3,264	150	81
DAP	1,779	1,136	643	1,109	86	77
Consumer Electronics	2,534	(246)	2,780	183	78	79
Lighting	5,133	3,886	1,238	3,307	249	217
Innovation & Emerging Businesses	1,409	1,001	297	1,001	68	49
Group Management & Services	19,122	705	4,068	605	30	59
	36,010	10,586	10,903	9,469	661	562
Discontinued operations	333		157			
	36,343		11,060			
2006						
Medical Systems	6,096	4,125	1,922	3,503	76	72
DAP	1,768	1,138	630	1,204	84	69
Consumer Electronics	2,516	(228)	2,735	149	72	71
Lighting	3,719	2,527	1,185	2,244	343	205
Innovation & Emerging Businesses	1,431	748	512	874	14	71
Group Management & Services	22,536	208	4,438	646	105	66
	38,066	8,518	11,422	8,620	694	554
Discontinued operations	431		169			
	38,497		11,591			
2005						
Medical Systems	5,160	3,179	1,942	2,673	65	64
DAP	896	370	526	449	73	85
Consumer Electronics	2,657	(296)	2,939	154	68	70
Lighting	3,642	2,491	1,132	2,196	206	164
Innovation & Emerging Businesses	1,072	226	2,406	324	80	102
Group Management & Services	15,994	(531)	2,122	744	145	57
	29,421	5,439	11,067	6,540	637	542
Discontinued operations	4,484		1,627			
	33,905		12,694			

The years 2005 and 2006 have been restated to present the MedQuist business as a discontinued operation.
Also, the years 2005 and 2006 have been restated to reflect certain reclassifications between the sectors related to: key portfolio changes, and the allocation of certain central cost to the operating divisions.

Goodwill assigned to sectors

	carrying value at January 1	acquisitions	divestments	impairment	translation differences and other changes	carrying value at December 31
2007						
Medical Systems	2,290	1			(233)	2,058
DAP	463	(4)			(42)	417
Consumer Electronics	18	11			(2)	27
Lighting	636	695			(87)	1,244
Innovation & Emerging Businesses	316	107			(34)	389
Group Management & Services						
	3,723	810			(398)	4,135

246 Reconciliation of non-US GAAP information 250 Corporate governance 258 The Philips Group in the last ten years 260 Investor information

Main countries

	sales	total assets	net operating capital	long-lived assets	capital expenditures	depreciation of property, plant and equipment
2007						
Netherlands	1,159	14,008	1,969	1,200	163	151
United States	6,725	8,125	6,766	5,172	118	103
Germany	2,014	1,364	(219)	305	50	46
France	1,784	694	(131)	103	23	26
United Kingdom	1,250	1,037	692	720	13	8
China	1,707	1,231	(516)	168	36	42
Other countries	12,154	9,551	2,025	1,801	258	186
	26,793	36,010	10,586	9,469	661	562
Discontinued operations		333				
		36,343				
2006						
Netherlands	1,088	10,646	3,479	1,132	242	162
United States	7,153	7,866	4,439	5,162	211	98
Germany	1,985	1,170	(449)	296	57	51
France	1,626	608	301	107	18	32
United Kingdom	1,186	1,194	717	792	4	6
China	1,740	1,115	(112)	176	31	42
Other countries	11,904	15,467	143	955	131	163
	26,682	38,066	8,518	8,620	694	554
Discontinued operations		431				
		38,497				
2005						
Netherlands	1,036	5,562	2,534	1,110	240	138
United States	6,803	7,087	3,273	3,743	56	74
Germany	1,916	1,191	(288)	276	70	44
France	1,680	655	(292)	129	21	35
United Kingdom	1,126	419	(150)	76	5	5
China	1,816	1,379	(256)	204	53	50
Other countries	11,068	13,128	618	1,002	192	196
	25,445	29,421	5,439	6,540	637	542
Discontinued operations		4,484				
		33,905				

The years 2005 and 2006 are restated to present the MedQuist business as a discontinued operation.

Significant accounting policies

Significant accounting policies

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (US GAAP). Historical cost is used as the measurement basis unless otherwise indicated.

Consolidation principles

The consolidated financial statements include the accounts of Koninklijke Philips Electronics N.V. (the Company) and all entities in which a direct or indirect controlling interest exists through voting rights or qualifying variable interests. All intercompany balances and transactions have been eliminated in the consolidated financial statements. Net income is reduced by the portion of the earnings of subsidiaries applicable to minority interests. The minority interests are disclosed separately in the consolidated statements of income and in the consolidated balance sheets. Unrealized losses are also eliminated but considered an impairment indicator of the assets transferred.

Foreign currencies

The financial statements of entities that use a functional currency other than the euro, are translated into euros. Assets and liabilities are translated using the exchange rates on the respective balance sheet dates. Items in the income statement and cash flow statement are translated into euros using the average rates of exchange for the periods involved. The resulting translation adjustments are recorded as a separate component of other comprehensive income (loss) within stockholders equity. Cumulative translation adjustments are recognized as income or expense upon partial or complete disposal or substantially complete liquidation of a foreign entity.

The functional currency of foreign entities is generally the local currency, unless the primary economic environment requires the use of another currency. When foreign entities conduct their business in economies considered to be highly inflationary, they record transactions in the Company s reporting currency (the euro) instead of their local currency.

Gains and losses arising from the translation or settlement of foreign-currency-denominated monetary assets and liabilities into the functional currency are recognized in income in the period in which they arise. However, currency differences on intercompany loans that have the nature of a permanent investment are accounted for as translation differences as a separate component of other comprehensive income (loss) within stockholders equity.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements in order to conform to generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. We evaluate these estimates and judgments on an ongoing basis and base our estimates on experience, current and expected future conditions, third-party evaluations and various other assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Actual results could differ materially from the estimate. Assumptions used are further explained in the related notes.

Estimates significantly impact goodwill and intangibles acquired, tax on activities disposed, impairments, financial instruments, liabilities from employee benefit plans, various provisions including tax and other contingencies such as asbestos product liability. The fair values of acquired identifiable intangibles are based on an assessment of future cash flows. Impairment analyses of goodwill and indefinite-lived intangible assets are performed annually and whenever a triggering event has occurred to determine whether the carrying value exceeds the recoverable amount These calculations are based on estimates of future cash flows.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgment to select a variety of methods including the discounted cash flow method and option valuation models and make assumptions that are mainly based on market conditions existing at each balance sheet date.

Actuarial assumptions are established to anticipate future events and are used in calculating pension and other postretirement benefit expense and liability. These factors include assumptions with respect to interest rates, expected investment returns on plan assets, rates of increase in health care costs, rates of future compensation increases, turnover rates, and life expectancy.

Accounting changes

The Company applies the retrospective method for reporting a change in accounting principle in the absence of explicit transition requirements for new accounting pronouncements.

Reclassifications

Certain items previously reported under specific financial statement captions have been reclassified to conform to the 2007 presentation.

Discontinued operations and non-current assets held for sale.

The Company has determined that the level of a reporting unit is the component for which operations and cash flows can be clearly distinguished from the rest of the Company and qualifies as a discontinued operation in the event of disposal of the component. A component of Philips qualified as a reporting unit is usually one level below the division level. Any gain or loss from disposal of a reporting unit together with the results of these operations until the date of disposal, is reported separately as discontinued operations. The financial information of a discontinued reporting unit is excluded from the respective captions in the consolidated financial statements and related notes and is reported separately.

Cash flow statements

Cash flow statements have been prepared using the indirect method. Cash flows in foreign currencies have been translated into euros using the average rates of exchange for the periods involved.

Cash flows from derivative instruments that are accounted for as fair value hedges or cash flow hedges are classified in the same category as the cash flows from the hedged items. Cash flows from other derivative instruments are classified consistent with the nature of the instrument.

Segments

Operating segments are components of the Company s business activities about which separate financial information is available that is evaluated regularly by the chief operating decision-maker or the Board of Management of the Company. The Board of Management decides how to allocate resources and assesses performance. The Company has determined that reportable segments are the same as the operating segments. Reportable segments comprise the Company s business sectors: Medical Systems, Domestic Appliances and Personal Care, Consumer Electronics, Lighting and Innovation & Emerging Businesses, and Group Management & Services. The sectors are organized based on the type of products produced and the nature of the markets served. Segment accounting policies are the same as the accounting policies as described in this note.

Earnings per share

The Company presents basic and diluted earnings per share (EPS) data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all potential dilutive common shares, which comprise convertible personnel debentures, restricted shares and share options granted to employees.

Revenue recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or the service has been provided, the sales price is fixed or determinable, and collectibility is reasonably assured. For consumer-type products in the segments

246 Reconciliation of non-US GAAP information 250 Corporate governance 258 The Philips Group in the last ten years 260 Investor information

Lighting, DAP and CE these criteria are generally met at the time the product is shipped and delivered to the customer and, depending on the delivery conditions, title and risk have passed to the customer and acceptance of the product, when contractually required, has been obtained, or, in cases where such acceptance is not contractually required, when management has established that all aforementioned conditions for revenue recognition have been met and no further post-shipment obligations exist other than obligations under warranty. Examples of the above-mentioned delivery conditions are Free on Board point of delivery and Costs, Insurance Paid point of delivery where the point of delivery may be the shipping warehouse or any other point of destination as agreed in the contract with the customer and where title and risk in the goods pass to the customer.

In accordance with EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables , revenues of transactions that have separately identifiable components are recognized based on their relative fair values. These transactions mainly occur in the Medical Systems segment for arrangements that require subsequent installation and training activities in order to become operable for the customer. However, since payment for the equipment is typically contingent upon the completion of the installation process, revenue recognition is deferred until the installation has been completed and the product is ready to be used by the customer in the way contractually agreed.

Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges.

For products for which a right of return exists during a defined period, revenue recognition is determined based on the historical pattern of actual returns, or in cases where such information is lacking, revenue recognition is postponed until the return period has lapsed. Return policies are typically based on customary return arrangements in local markets.

For products for which a residual value guarantee has been granted or a buy-back arrangement has been concluded, revenue recognition takes place in accordance with the requirements for lease accounting of SFAS No.13, Accounting for Leases .

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

A provision for product warranty is made at the time of revenue recognition and reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to the sold products. In cases where the warranty period is extended and the customer has the option to purchase such an extension, which is subsequently billed to the customer, revenue recognition occurs on a straight-line basis over the contract period.

Royalty income, which is generally earned based upon a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis. Government grants, other than those relating to purchases of assets, are recognized as income as qualified expenditures are made.

Benefit accounting

The Company accounts for the cost of pension plans and postretiremen! benefits other than pensions in accordance with SFAS No. 87, Employers Accounting for Pensions , and SFAS No.106, Postretirement Benefits other than Pensions , respectively.

Most of the Company s defined-benefit pension plans are funded with plan assets that have been segregated and restricted in a trust or foundation to provide for the pension benefits to which the Company has committed itself. When plan assets have not been segregated, the Company recognizes a provision for such amounts.

Pension costs in respect of defined-benefit pension plans primarily represent the increase in the actuarial present value of the obligation for pension benefits based on employee service during the year and the interest on this obligation in respect of employee service in previous years, net of the expected return on plan assets.

Actuarial gains and losses arise mainly from changes in actuarial assumptions and differences between actuarial assumptions and what has actually occurred. They are recognized in the income statement, over the expected average

remaining service periods of the employees, only to the extent that their net cumulative amount exceeds 10% of the greater of the present value of the obligation or of the fair value of plan assets at the end of the previous year (the corridor). Unrecognized gains and losses in the Netherlands, France and Thailand are recognized by a straight-line amortization over the expected average remaining service period without applying the corridor.

Effective December 31,2006, the funded status of the Company s defined-benefit pension plans and postretirement benefits other than pensions is reflected on the balance sheet in accordance with SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Benefit plans . The funded status is measured as the difference between plan assets at fair value and the benefit obligation. For a defined-benefit pension plan, the benefit obligation is the projected benefit obligation; for any other postretirement benefit plan it is the accumulated postretirement benefit obligation. Actuarial gains and losses, prior-service costs or credits and the transition obligation remaining from the initial application of SFAS 106 that are not yet recognized as components of net periodic benefit cost are recognized, net of tax, as a component of accumulated other comprehensive income. Amounts recognized in accumulated other comprehensive income are adjusted as they are subsequently recognized as components of net periodic pension cost.

Prior to adopting SFAS No. 158 as of December 31,2006, the Company recognized an additional minimum pension liability. To the extent that the accumulated benefit obligation, calculated as the present value of the benefits attributed to employee service rendered and based on current and past compensation levels, exceeded the market value of the plan assets and existing accrued pension liabilities, this difference and the existing prepaid pension assets were recognized as an additional minimum pension liability.

Upon adoption of SFAS No. 158, the Company presented the effect of adopting SFAS No. 158 as a component of total comprehensive income. This net effect of EUR 477 million should not have been included in total comprehensive income but only as an adjustment to total accumulated other comprehensive income. The 2006 total comprehesive income has been adjusted to reflect the application of SFAS No. 158 appropriately.

In certain countries, the Company also provides postretirement benefits other than pensions. The cost relating to such plans consists primarily of the present value of the benefits attributed on an equal basis to each year of service, interest cost on the accumulated postretirement benefit obligation, which is a discounted amount, and amortization of the unrecognized transition obligation. This transition obligation is being amortized through charges to earnings over a twenty-year period beginning in 1993 in the USA and in 1995 for all other plans.

Unrecognized prior-service costs related to pension plans and postretirement benefits other than pensions are being amortized by assigning a proportional amount to the income statements of a number of years, reflecting the average remaining service period of the active employees.

Obligations for contributions to defined-contribution pension plans are recognized as an expense in the income statement as incurred.

Share-based payments

In 2006, the Company adopted SFAS No.123(R), Share-Based Payment , using the modified prospective method. Under the provisions of SFAS No. 123(R), the Company recognizes the estimated fair value of equity instruments granted to employees as compensation expense over the vesting period on a straight-line basis, taking into account estimated forfeitures. The Company had previously adopted the fair value provisions of SFAS No. 123 prospectively for all employer awards granted, modified or settled after January 1,2003.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions for all outstanding and unvested awards in 2005. There was no impact in 2006 and 2007.

Significant accounting policies

	2005
Net income	
As reported	2,868
Add: Stock-based compensation expenses included in reported net income, net of related taxes	65
Deduct: stock-based compensation expenses determined using the fair-value method, net of related taxes	(77)
Pro forma	2,856
Basic earnings per share (in euros):	
As reported	2.29
Pro forma	2.28
Diluted earnings per share (in euros):	
As reported	2.29
Pro forma	2.28

The fair value of the amount payable to employees in respect of share-based payments which are settled in cash is recognized as an expense, with a corresponding increase in liabilities, over the vesting period. The liability is remeasured at each reporting date and at settlement date. Any changes in fair value of the liability are recognized as compensation expense in the income statement.

Research and development

Costs of research and development are expensed in the period in which they are incurred.

Advertising

Advertising costs are expensed as incurred.

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are recognized in the income statement on a straight-line basis over the term of the lease.

Leases in which the Company has substantially all the risk and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease s commencement at the lower of the fair value of leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest on the finance balance liabilities. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the assets and the lease term.

Income taxes

Income taxes are accounted for using the asset and liability method. Income tax is recognized in the income statement except to the extent that it relates to an item recognized directly within stockholders equity, including other comprehensive income (loss), in which case the related tax effect is also recognized there. Current-year deferred taxes related to prior-year equity items which arise from changes in tax rates or tax laws are included in income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Measurement of deferred tax assets and liabilities is based on the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets, including assets arising from loss carryforwards, are recognized, net of a valuation allowance, if it is more likely than not that the asset or a portion thereof will not be realized. Deferred tax assets and liabilities are not discounted.

Deferred tax liabilities for withholding taxes are recognized for subsidiaries in situations where the income is to be paid out as dividends in the foreseeable future, and for undistributed earnings of unconsolidated companies.

Changes in tax rates are reflected in the period in which such change is enacted.

Uncertain tax position

Income tax benefit from an uncertain tax position is recognized only if it is more likely than not that the tax position will be sustained upon examination by the relevant taxing authorities, based on the technical merits of the position. The income tax benefit recognized in the financial statements from such position is measured based on the largest benefit that is more than 50% likely to be realized upon settlement with a taxing authority that has full knowledge of all relevant information. The liability for unrecognized tax benefits, including related interest and penalties, is recorded as other non-current liabilities. Interest is presented as part of financial expenses while penalty is classified as part of current tax expense in the income statement.

Derivative financial instruments

The Company uses derivative financial instruments principally for the management of its foreign currency risks and to a more limited extent for interest rate and commodity price risks. All derivative financial instruments are classified as assets or liabilities and are accounted for at trade date. The Company measures all derivative financial instruments based on fair values derived from market prices of the instruments or from option pricing models, as appropriate. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset, liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in the income statement. Gains or losses arising from changes in fair value of derivatives are recognized in the income statement, except for derivatives that are highly effective and qualify for cash flow or net investment hedge accounting.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, are recorded in accumulated other comprehensive income, until earnings are affected by the variability in cash flows of the designated hedged item.

Changes in the fair value of derivatives that are highly effective as hedges and that are designated and qualify as foreign currency hedges are recorded in either earnings or accumulated other comprehensive income, depending on whether the hedge transaction is a fair value hedge or a cash flow hedge.

The Company formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is established that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. When hedge accounting is discontinued because it has been established that the derivative no longer qualifies as an effective fair value hedge, the Company continues to carry the derivative on the balance sheet at its fair value, and no longer adjusts the hedged asset or liability for changes in fair value. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur within a period of two months from the originally forecasted transaction date, the Company continues to carry the derivative on the balance sheet at its fair value, and gains and losses that were accumulated in other comprehensive income are recognized immediately in the income statement. In all other situations in which hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the balance sheet, and recognizes any changes in its fair value in the income statement.

Foreign currency differences arising on the translation of a financial liability designated as a hedge of a net investment in a foreign operation are recognized directly as a separate component of equity, to the extent that the hedge is effective. To the extent that the hedge is ineffective, such differences are recognized in the income statement.

For interest rate swaps designated as a fair value hedge of an interest-bearing asset or liability that are unwound, the amount of the fair value adjustment to the asset or liability for the risk being hedged is released to the income statement over the remaining life of the asset or liability based on the recalculated effective yield.

Non-derivative financial instruments

Non-derivative financial instruments are recognized initially at cost or fair value. Financial assets transferred to another party are derecognized to the extent that the Company surrenders control over those assets in exchange for a consideration other than beneficial exchange for interest in the transferred assets. Financial liabilities are

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

derecognized if and only if they are extinguished. Non-derivative financial instruments are accounted for as a sale to the extent that a consideration other than beneficial interests in the transferred assets is received in exchange. The Company has surrendered control over transferred assets if and only if: (i) the transferred assets have been isolated from the Company beyond its reach and its creditor even in bankruptcy or other receivership, (ii) the transferree has the right to pledge or exchange the assets it received, and no condition both constrains the transferee from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the Company, and (iii) the Company does not maintain effective control over the transferred assets.

Regular way purchases and sales of financial instruments are accounted for at trade date, i.e., the date that the Company commits itself to purchase or sell the instrument Dividend and interest income are recognized when earned. Gains or losses, if any, are recorded in financial income and expenses.

Cash and cash equivalents

Cash and cash equivalents include all cash balances and short-term highly liquid investments with an original maturity of three months or less that are readily convertible into cash. They are stated at face value, which approximates their fair value.

Receivables

Trade accounts receivable are carried at face value, net of allowances for doubtful accounts. As soon as trade accounts receivable can no longer be collected in the normal way and are expected to result in a loss, they are designated as doubtful trade accounts receivable and valued at the expected collectible amounts. They are written off when they are deemed to be uncollectible due to bankruptcy or other forms of receivership of the debtors.

The allowance for the risk of non-collection of trade accounts receivable takes into account credit-risk concentration, collective debt risk based on average historical losses and specific circumstances such as serious adverse economic conditions in a specific country or region.

In the events of sale of receivables and factoring, the Company derecognizes the receivables and accounts for them as a sale only to the extent that the Company has surrended control over the receivables in exchange for a consideration other than beneficial interest in the transferred receivables.

Long-term receivables are initially recognized at their net present value using an appropriate interest rate. Any discount is amortized to income over the life of the receivable using the effective yield.

Debt and other liabilities

Debt and liabilities other than provisions are stated at amortized cost. However, loans that are hedged under a fair value hedge are remeasured for the changes in the fair value that are attributable to the risk that is being hedged. Currently, the Company does not have any financial instruments that are affected by SFAS No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity .

Investments in equity-accounted investees

Investments in companies in which the Company does not have the ability to directly or indirectly control the financial and operating decisions, but does possess the ability to exert significant influence, are accounted for using the equity method. In the absence of demonstrable proof of significant influence, it is presumed to exist if at least 20% of the voting stock is owned. The Company s share of the net income of these companies is included in results relating to equity-accounted investees in the consolidated statements of income. When the Company s share of losses exceeds the carrying amount of an investment accounted for by the equity method, the Company s carrying amount of that investment is reduced to zero and recognition of further losses is discontinued unless the Company has guaranteed obligations of the investee or is otherwise committed to provide further financial support to the investee.

Investments in equity-accounted investees include loans from the Company to these investees.

Accounting for capital transactions of a consolidated subsidiary or an equity-accounted investee

The Company recognizes dilution gains or losses arising from the sale or issuance of stock by a consolidated subsidiary or an equity-accounted investee in the income statement, unless the Company or the subsidiary either has reacquired or has plans to reacquire such shares. In such instances, the result of the transaction will be recorded directly in stockholders equity.

The dilution gains or losses are presented on a separate line in the income statement if they relate to consolidated subsidiaries. Dilution gains and losses related to equity-accounted investees are presented under Results relating to equity-accounted investees.

Other non-current financial assets

Other non-current financial assets include available-for-sale securities, held-to-maturity securities, loans and cost-method investments.

The Company classifies its investments in equity securities that have readily determinable fair values as either available-for-sale or for trading purposes. Trading securities are acquired and held principally for the purpose of selling them in the short term and are presented as Other current assets . Trading securities are recorded at fair value with changes in the fair value going to financial income and expense. All securities not included in trading or held-to-maturity are classified as available-for-sale. Available-for-sale equity securities are recorded at fair value with changes going through other comprehensive income in stockholders equity. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of other comprehensive income within stockholders equity until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a first-in, first-out basis. For available-for-sale securities hedged under a fair value hedge, the changes in the fair value that are attributable to the risk which is being hedged are recognized in earnings rather than in other comprehensive income.

Held-to-maturity securities are those debt securities which the Company has the ability and intent to hold until maturity. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization of discounts or accretion of premiums using the effective interest method.

Loans receivable are stated at amortized cost, less the related allowance for impaired loans receivable.

Investments in privately-held companies are carried at cost, or estimated fair value, if an other-than-temporary decline in value has occurred.

Dividend and interest income are recognized when earned. Gains or losses, if any, are recorded in financial income and expenses.

Impairments of financial assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. The Company assesses its long-term investments accounted for as available-for-sale on a quarterly basis to determine whether declines in market value below cost are other-than-temporary, the cost basis for the individual security is reduced and a loss is realized in the period in which it occurs. When the decline is determined to be temporary, the unrealized losses are included in other comprehensive income.

If objective evidence indicates that cost-method investments need to be tested for impairment, calculations are based on information derived from business plans and other information available for estimating their fair value.

Inventories

Inventories are stated at the lower of cost or market, less advance payments on work in progress. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, taking into account the stage of completion and the normal capacity of the production facilities. Costs of idle facility and waste are expensed. The cost of inventories is determined using the first-in, first-out (FIFO) method. Inventory is reduced for the estimated losses due to obsolescence, which establishes a new cost basis. This reduction is determined for groups of products based on purchases in the recent past and/or expected future demand.

Property, plant and equipment

Property, plant and equipment is stated at cost, less accumulated depreciation. Assets manufactured by the Company include direct manufacturing costs, production overheads and interest charges incurred during the construction period. Government grants are

Significant accounting policies

deducted from the cost of the related asset. Depreciation is calculated using the straight-line method over the useful life of the asset. Depreciation of special tooling is generally based on the straight-line method. Gains and losses on the sale of property, plant and equipment are included in other business income. Costs related to repair and maintenance activities are expensed in the period in which they are incurred unless they lead to an extension of the economic life or capacity of the asset. Plant and equipment under capital leases and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the asset.

The Company recognizes the fair value of an asset retirement obligation in the period in which it is incurred, while an equal amount is capitalized as part of the carrying amount of the long-lived asset and subsequently depreciated over the useful life of the asset.

Intangible assets

Intangible assets are amortized using the straight-line method over their estimated useful lives. Remaining useful lives are evaluated every year to determine whether events and circumstances warrant a revision to the remaining period of amortization. Intangible assets that are expected to generate cash inflows during a period without a foreseeable limit, are regarded as intangibles with an indefinite useful life. These assets are not amortized, but tested for impairment annually and whenever an impairment trigger indicates that the asset may be impaired. In-process research and development with no alternative use is written off immediately upon acquisition. Patents, trademarks and other intangibles acquired from third parties are capitalized at cost and amortized over their remaining useful lives.

Certain costs relating to the development and purchase of software for internal use are capitalized and subsequently amortized over the estimated useful life of the software.

Eligible costs relating to the production of software intended to be sold, leased or otherwise marketed are capitalized and subsequently amortized over the estimated useful life of the software.

Impairment or disposal of long-lived assets other than goodwill and indefinite-lived intangibles

The Company accounts for long-lived assets in accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets . This Statement requires that long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison between the carrying amount of an asset and the future undiscounted net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted net cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. The Company determines the fair value based on discounted projected cash flows. The review for impairment is carried out at the level where discrete cash flows occur that are largely independent of other cash flows. Assets held for sale are reported at the lower of the carrying amount or fair value, less cost to sell.

Goodwill and indefinite lived intangibles

The Company accounts for goodwill and indefinite lived tangibles in accordance with the provisions of SFAS No. 141 Business Combinations and SFAS No. 142 Goodwill and Other Intangible Assets . Accordingly, goodwill and indefinite lived intangibles are not amortized but tested for impairment annually and whenever impairment indicators require so. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. This determination is made at the reporting unit level, which has been determined by the Company to be the level of an entity that reports discrete financial information to the Board of Management, which is usually one level below the division level.

The goodwill impairment test of consists of two steps. First, the Company determines the carrying value of each reporting unit by assigning the assets and liabilities, including the goodwill and intangible assets, to those reporting units. Furthermore, the Company determines the fair value of each reporting unit and compares it to the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds the fair value of the reporting unit, the

Company performs the second step of the impairment test. In the second step, the Company compares the implied fair value of the reporting unit s goodwill with the carrying amount of the reporting unit s goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation upon a business combination in accordance with SFAS No. 141. The residual fair value after this allocation is the implied fair value of the reporting unit s goodwill. The Company generally determines the fair value of the reporting units based on discounted projected cash flows.

Share capital

Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity. When share capital recognized as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognized as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from stockholders equity.

Provisions

The Company recognizes provisions for liabilities and probable losses that have been incurred as of the balance sheet date and for which the amount is uncertain but can be reasonably estimated.

Provisions of a long-term nature are stated at present value when the amount and timing of related cash payments are fixed or reliably determinable. Short-term provisions are stated at face value.

The Company applies the provisions of SOP 96-1, Environmental liabilities and SFAS No. 5, Accounting for Contingencies and accrues for losses associated with environmental obligations when such losses are probable and reasonably estimatable. Additionally, in accordance with SOP 96-1, the Company accrues for certain costs such as compensation and benefits for employees directly involved in the remediation activities. Measurement of liabilities is based on current legal requirements and existing technology. Liabilities and probable insurance recoveries, if any, are recorded separately. The carrying amount of liabilities is regularly reviewed and adjusted for new facts or changes in law or technology.

Restructuring

The provision for restructuring relates to the estimated costs of initiated reorganizations that have been approved by the Board of Management. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in restructuring provisions.

SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities requires that a liability be recognized for those costs only when the liability is incurred, i.e. when it meets the definition of a liability. SFAS No. 146 also establishes fair value as the objective for initial measurement of the liability.

Liabilities related to one-time employee termination benefits are recognized ratably over the future service period if those employees are required to render services to the Company, if that period exceeds 60 days or a longer legal notification period.

Employee termination benefits covered by a contract or under an ongoing benefit arrangement continue to be accounted for under SFAS No. 112, Employer s Accounting for Postemployment Benefits and are recognized when it is probable that the employees will be entitled to the benefits and the amounts can be reasonably estimated.

Guarantees

The Company complies with FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others . In accordance with this interpretation, the Company recognizes a liability for the fair value of the obligation incurred for guarantees within the scope of the recognition criteria of the Interpretation, including minimum revenue guarantees.

Accounting standards adopted in 2007

Several accounting pronouncements relevant to the Company were adopted in 2007:

SFAS No. 156 Accounting for Servicing of Financial Assets

The Company adopted SFAS No. 156 Accounting for Servicing of Financial Assets , an amendment to SFAS No. 140 with respect to the accounting for separately recognized servicing assets and servicing liabilities, with the effective date January 1,2007. The statement requires among others to recognize a servicing liability upon sale of financial assets while entering into a servicing contact. The effects of adopting this standard were not material.

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

FIN 46 (R) 6 Determining the Variability to be Considered in Applying FASB Interpretation No. 46(R)

This FASB interpretation was issued on April 13, 2006 and addresses how a company should determine the variability to be considered for variable interest entities. Adoption of this FSP did not change the conclusions of assessments of variable interest entities in previous periods.

FIN 48 Accounting for Uncertainty in Income Taxes

The Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 , which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes . This interpretation provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such position should be measured based on the largest benefit that is more than 50% likely to be realized upon settlement with a taxing authority. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 as of January 1, 2007 and this did not result in an adjustment to existing liabilities nor the opening balance of retained earnings.

Accounting standards effective as from 2008

FASB issued several pronouncements with an effective date on or after January 1, 2008, of which the following are applicable to the Company:

SFAS No. 157 Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements . This standard establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. SFAS No. 157 is effective for all fiscal years beginning after November 15, 2007 (January 1, 2008 for Philips) and is to be applied prospectively. The Company is currently evaluating the impacts and disclosures of this standard.

SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities . SFAS No. 159 permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value is elected shall be recognized in the income statements as incurred and not deferred. SFAS No. 159 also established presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008 for Philips). The Company has evaluated this Standard and at present does not plan to avail itself of this option.

Notes to the group financial statements

Notes to the Group financial statements

All amounts in millions of euros unless otherwise stated. The years 2005 and 2006 have been restated to present the MedQuist business as a discontinued operation. Also, the years 2005 and 2006 have been restated to reflect certain reclassifications between the sectors related to: key portfolio changes, and the allocation of certain central costs to the operating divisions.

1

Discontinued operations

MedQuist

On November 2, 2007, the Company announced the decision to proceed with the sale of its approximately 70% ownership interest in MedQuist. The financial results attributable to the Company s interest in MedQuist have been presented as discontinued operations. Prior-year consolidated financial statements have been restated to conform to this presentation. The decision has resulted in an impairment charge of EUR 325 million in 2007, presented under discontinued operations. This non-cash charge does not affect equity as it relates to the cumulative translation differences of the USD-denominated investment in MedQuist, which have accumulated within equity since the date of acquisition.

The following table summarizes the results of the MedQuist business included in the consolidated statements of income as discontinued operations for 2005, 2006 and 2007:

	2005	2006	2007
Sales	330	293	244
Costs and expenses	(412)	(304)	(271)
Impairment charge			(360)1)
Income (loss) before taxes	(82)	(11)	(387)
Income tax	20	29	(8)
Result of equity- accounted investees			1
Minority interests	14		4
Results from discontinued operations	(48)	18	(390)

1) Including EUR 35 million following the annual impairment test.

The following table presents the assets and liabilities of the MedQuist business, classified as discontinued operations, in the consolidated balance sheets as at December 31, 2006 and 2007:

	2006	2007

Cash and cash equivalents	137	108
Accounts receivable	41	41
Equity-accounted investees	4	4
Property, plant and equipment	15	16
Intangible assets including goodwill	199	141
Other assets	35	23
Assets of discontinued operations	431	333
Accounts payable	6	9
Provisions	32	32
Other liabilities	40	37
Minority interest	91	79
Liabilities of discontinued operations	169	157

Semiconductors

On September 29, 2006, the Company sold a majority stake in its Semiconductors division to a private equity consortium led by Kohlberg Kravis Robert & Co. (KKR). The transaction consisted of the sale of the division for a total consideration of EUR 7,913 million and a simultaneous acquisition of a minority interest in the recapitalized organization NXP Semiconductors at a cost of EUR 854 million. A gain of EUR 4,283 million was recorded on the sale, net of taxes, and net of costs directly associated with this transaction of approximately EUR 367 million.

The operations of the Semiconductors division and the aforementioned gain have been presented as discontinued operations. Prior-year consolidated financial statements have been restated to conform to this presentation.

The Company s ownership interest in NXP Semiconductors consists of 19.9% of the preferred shares and 17.5% of the common shares. The Company cannot exert significant influence over the operating or financial policies of NXP and the investment is accounted for as a cost-method investment under other non-current financial assets.

Philips and NXP have continuing relationships through shared research and development activities and through license agreements. Additionally, through the purchase of component products, namely semiconductor products for the consumer electronic sector, Philips and NXP have a continuing relationship for the foreseeable future. The Company assessed the expected future transactions and determined that the cash flows from these transactions are not significant direct cash flows.

The following table summarizes the results of the Semiconductors division included in the consolidated statements of income as discontinued operations for 2005 and the period through its divestment on September 29, 2006. The 2007 results mainly relate to the settlement of pensions and income taxes.

	2005	2006	2007
Sales	4,620	3,681	
Costs and expenses	(4,313)	(3,319)	
Result on sale of discontinued operations		4,953	(69)
Income (loss) before taxes	307	5,315	(69)

Income taxes	(80)	(768)	26
Result of equity- accounted investees	(73)	(63)	
Minority interests	(34)	(49)	
Results from discontinued operations	120	4,435	(43)

The following table shows the components of the gain from the sale of the Semiconductors division, net of tax on December 31, 2006:

	2006
Consideration	7,913
Carrying value of net assets disposed	(2,593)
Cost of disposal	(367)
Gain on disposal before taxes	4,953
Income taxes	(670)
Gain on sale	4,283

246 Reconciliation of non-US GAAP information
250 Corporate governance
258 The Philips Group in the last ten years
260 Investor information

Philips Mobile Display Systems

On November 10, 2005, Philips and Toppoly Optoelectronics Corporation of Taiwan announced that they had signed a binding letter of intent to merge Philips Mobile Display Systems (MDS) business with Toppoly. The company was named TPO, and the transaction was completed in the first half of 2006.
Philips separately reported the results of the MDS business as a discontinued operation, and previous years were restated.
The following table summarizes the results of the MDS business included in the consolidated statements of income as discontinued operations for 2005 and 2006:

	2005	2006
Sales	653	194
Costs and expenses	(736)	(165)
Income (loss) before taxes	(83)	29
Income taxes		
Results from discontinued operations	(83)	29

The 2006 results of EUR 29 million mainly relate to translation differences upon completion of the transaction. The 2005 results included an impairment loss of EUR 69 million.

2
Acquisitions and divestments
2007

During 2007, Philips entered into a number of acquisitions and completed several disposals of activities. All business combinations have been accounted for using the purchase method of accounting.
Major business combinations in 2007 relate to the acquisitions of Partners in Lighting and Color Kinetics, currently Philips Solid-State Lighting Solutions. The remaining business combinations, both individually and in the aggregate, were deemed immaterial in respect of the SFAS No. 141 disclosure requirements.
Sales and income from operations related to activities divested in 2007, included in the Company s consolidated statement of income for 2007, amounted to EUR 262 million and a loss of EUR 39 million, respectively.
The most significant acquisitions and divestments are summarized in the next two tables and described in the section below.

Acquisitions

	cash outflow	net assets acquired[1)]	other intangible assets	goodwill
Partners in Lighting	561	47	217	297
Color Kinetics	515	(29)	187	357

1) Excluding cash acquired

Divestments

	net assets	recognized

	cash inflow[1)]	divested[2)]	gain (loss)
LG.Philips LCD	1,548	1,040	508

1) Net of cash divested

2) Includes the release of cumulative translation differences

Partners in Lighting (PLI)

On February 5, 2007, Philips acquired 100% of the shares of PLI, a leading European manufacturer of home luminaires. Philips acquired PLI from CVC Capital Partners, a private equity investment company, at a net cash consideration of EUR 561 million paid upon completion of the transaction. As of the date of acquisition, PLI has been consolidated within the Lighting division.

The following table summarizes the fair value of PLI s assets and liabilities acquired on February 5, 2007:

	February 5, 2007
Total purchase price (net of cash)	561
Allocated to:	
Property, plant and equipment	97
Other non-current financial assets	1
Working capital	114
Deferred tax liabilities	(67)
Long-term debt	(50)
Short-term debt	(34)
Provisions	(14)
Intangible assets	217
Goodwill	297
	561

The goodwill recognized is related to the complementary technical skills and talent of PLI s workforce and the synergies expected to be achieved from integrating PLI into the Lighting division.

Intangible assets comprise:

	amount	amortization period in years
Customer relationships	156	20
Trademarks and trade names	61	20
	217	

PLI contributed a positive income from operations of EUR 24 million to the Group for the period from February 5 to December 31, 2007.

Color Kinetics

On August 24, 2007, Philips completed the acquisition of 100% of the shares Color Kinetics, a leader in designing and marketing innovative lighting systems based on Light Emitting Diode (LED) technology at a net cash consideration of EUR 515 million. As of the date of acquisition Color Kinetics has been consolidated within the Lighting division.

The following table summarizes the initial fair value of Color Kinetics assets and liabilities acquired on August 24, 2007:

	August 24, 2007
Total purchase price (net of cash)	515
Allocated to:	
Property, plant and equipment	7
Working capital	16
Deferred tax	(52)
Intangible assets	186
In process R&D	1
Goodwill	357
	515

The allocation of the purchase price to the net assets acquired had not yet been finalized as of December 31, 2007, as further information related to intangible asset valuations and certain other matters remained outstanding. The goodwill recognized is related mainly to the complementary technological expertise of Color Kinetics workforce and the synergies expected to be achieved from integrating Color Kinetics into the Lighting division.

Notes to the group financial statements

The amount of purchased in-process research and development acquired and written off in 2007 was EUR 1 million. This amount is included in the consolidated statement of income under Research and development expenses.
Other intangible assets, excluding in-process research and development, are comprised of the following:

	amount	amortization period in years
Trademarks and trade names	1	1
Developed and core technology	113	10-20
Customer relationships	68	7-18
Other	4	2-10
	186	

Color Kinetics contributed a loss from operations of EUR 8 million to the Group for the period from August 24 to December 31, 2007.
Pro forma disclosures on acquisitions
The following table presents the year-to-date unaudited pro-forma results of Philips, assuming PLI and Color Kinetics had been consolidated as of January 1, 2007:

Unaudited

	January-December 2007		
	Philips Group	pro forma adjustments[1)]	pro forma Philips Group
Sales	26,793	75	26,868
Income from operations	1,852		1,852
Net income	4,168	(2)	4,166
Basic earnings per share in euros	3.84		3.84

1) Pro forma adjustments include sales, income from operations and net income from continuing operations of the acquired companies from January 1, 2007 to the date of acquisition. As Philips finances its acquisitions

with own funds, the pro forma adjustments exclude the cost of external funding incurred prior to the acquisition. The pro forma adjustments reflect the impact of the purchase- price accounting effects from January 1, 2007 to the date of acquisition and elimination of non-recurring integration costs. Purchase-price accounting effects primarily relate to the amortization of intangible assets (EUR 10 million, excluding the write-off of research and development assets).

The following table presents the year-to-date unaudited pro-forma results of Philips, assuming PLI and Color Kinetics had been consolidated as of January 1, 2006:

Unaudited

	January-December 2007		
	Philips Group	pro forma adjustments[1)]	pro forma Philips Group
Sales	26,682	454	27,136
Income from operations	1,201	14	1,215
Net income	5,383	26	5,409
Basic earnings per share in euros	4.58		4.60

1) Pro forma adjustments

include sales, income from operations and net income from continuing operations of the acquired companies for 2006. As Philips finances its acquisitions with own funds, the pro forma adjustments exclude the cost of external funding incurred in 2006. The pro forma adjustments also reflect the impact of the purchase-price accounting effects of 2006. These effects primarily relate to the amortization of intangible assets (EUR 26 million, excluding the write-off of research and development assets) and inventory step-ups (EUR 26 million).

LG.Philips LCD

On October 10, 2007, Philips sold 46,400,000 shares of common stock in LG.Philips LCD (LPL) to financial institutions in a capital markets transaction. This transaction represented 13% of LPL s issued share capital and reduced Philips holding to 19.9%. The transaction resulted in a gain of EUR 508 million, reported under Results relating to equity-accounted investees.

Philips is represented on the board of directors and continued to exercise influence by participating in the policy-making processes of LPL. Accordingly, Philips continued to apply equity accounting for LPL in 2007.

2006

During 2006, Philips entered into a number of acquisitions and completed several divestments. All acquisitions have been accounted for using the purchase method of accounting.

Major acquisitions in 2006 relate to the acquisitions of Lifeline Systems (Lifeline), Witt Biomedical, Avent and Intermagnetics. The remaining acquisitions, both individually and in the aggregate, were deemed immaterial in respect of the SFAS No. 141 disclosure requirements.

Sales and income from operations related to activities divested in 2006, included in the Company s consolidated statement of income for 2006, amounted to EUR 975 million and a loss of EUR 54 million, respectively.

The most significant acquisitions and divestments are summarized in the next two tables and described in the section below.

Acquisitions

	cash outflow	net assets acquired[1)]	other intangible assets	goodwill
Lifeline	583	(77)	319	341
Witt Biomedical	110	(9)	29	90
Avent	689	(47)	392	344
Intermagnetics	993	(53)	313	733

1 Excluding cash acquired

Divestments

	cash inflow[1)]	net assets divested[2)]	recognized gain
CryptoTec	30	(1)	31
Philips Enabling Technologies (ETG)	45	42	3
Philips Sound Solutions (PSS)	53	10	43
FEI Company	154	78	76

1) Net of cash divested

2) Includes the release of cumulative translation differences

Table of Contents

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Lifeline

On March 22, 2006, Philips completed its acquisition of Lifeline, a provider of personal emergency response services. Philips acquired a 100% interest in Lifeline by paying USD 47.75 per share in cash. As of the date of acquisition, Lifeline has been consolidated, as part of Consumer Healthcare Solutions, within the Innovation & Emerging Businesses sector.

The following table summarizes the fair value of Lifeline s assets and liabilities acquired on March 22, 2006:

	March 22, 2006
Total purchase price (net of cash)	583
Allocated to:	
Property, plant and equipment	20
Other non-current financial assets	19
Working capital	8
Deferred tax liabilities	(124)
Intangible assets	319
Goodwill	341
	583

Intangible assets comprise:

	amount	amortization period in years
Trademarks and trade names	114	indefinite
Software	9	3-5
Customer relationships	196	5-20
	319	

Witt Biomedical

On April 26, 2006, Philips completed its acquisition of Witt Biomedical, the largest independent supplier of hemodynamic monitoring and clinical reporting systems used in cardiology catheterization laboratories. As of the date of aquisition, Witt Biomedical has been consolidated within the Medical Systems sector. Goodwill on this acquisition is tax-deductible.

The following table summarizes the fair value of Witt Biomedical s assets and liabilities acquired on April 26, 2006:

	April 26, 2006
Total purchase price (net of cash)	110
Allocated to:	
Property, plant and equipment	1
Working capital	10
Deferred tax	4
Provisions	(24)
Intangible assets	25

In-process R&D	4
Goodwill	90
	110

Intangible assets comprise:

	amount	amortization period in years
Backlog	7	1
Developed and core technology	11	4
Customer relationships and patents	6	10
Other	1	3
	25	

Avent

As of August 31, 2006, Philips completed its acquisition of Avent, a provider of baby and infant feeding products in the United Kingdom and the United States. Philips acquired Avent for EUR 689 million, which was paid in cash upon completion of the transaction. As of the date of acquisition Avent has been consolidated within the Domestic Appliances and Personal Care sector.

The following table summarizes the fair value of Avent s assets and liabilities acquired on August 31, 2006:

	August 31, 2006
Total purchase price (net of cash)	689
Allocated to:	
Property, plant and equipment	35
Working capital	40
Deferred tax liabilities	(122)
Intangible assets	392
Goodwill	344
	689

Intangible assets comprise:

	amount	amortization period in years
Trademarks and trade names	242	indefinite
Customer relationships and patents	150	5-18
	392	

Intermagnetics

On November 9, 2006, Philips acquired Intermagnetics for USD 27.50 per share, which was paid in cash upon completion. Additionally, in connection with the closing, Philips provided a loan to Intermagnetics of approximately USD 120 million to pay off debt and certain other obligations, including amounts related to the acceleration of stock-based compensation and expenses incurred as a result of the transaction. Since the date of acquisition, Intermagnetics has been consolidated within the Medical Systems sector.

Notes to the group financial statements

The following table summarizes the fair value of Intermagnetics assets and liabilities acquired on November 9, 2006:

	November 9, 2006
Total purchase price (net of cash)	993
Allocated to:	
Property, plant and equipment	45
Working capital	66
Deferred tax liabilities	(96)
Provisions	(9)
Long-term debt	(1)
Short-term debt	(58)
In-process R&D	39
Other intangible assets	274
Goodwill	733
	993

Adjusted for the effects of the final purchase price allocation completed in 2007.

The amount of purchased in-process research and development acquired and written off was EUR 39 million. This amount is included in the consolidated statement of income under Research and development expenses.

Other intangible assets, excluding in-process research and development, is comprised of the following:

	amount	amortization period in years
Core and existing technology	181	6
Trademarks and trade names	8	10
Customer relationships	81	9
Miscellaneous	4	2
	274	

Intermagnetics has developed, designed, manufactured and supplied superconducting magnet systems and certain other components used in magnetic resonance imaging systems to Philips for use in medical systems. This pre-existing relationship involved EUR 120 million of Intermagnetics revenues in 2006.

Pro forma disclosures on acquisitions

The following table presents the year-to-date unaudited pro-forma results of Philips, assuming Lifeline, Witt Biomedical, Avent and Intermagnetics had been consolidated as of January 1, 2006:

Unaudited

	January-December 2006		
	Philips Group	pro forma adjustments[1)]	pro forma Philips Group
Sales	26,682	236	26,918
Income from operations	1,201	(7)	1,194

Net income		5,383	(2)	5,381
Basic earnings per share	in euros	4.58		4.58

1) Pro forma adjustments include sales, income from operations and net income from continuing operations of the acquired companies from January 1, 2006 to the date of acquisition. For that purpose, sales related to the pre-existing relationship between Philips and Intermagnetics have been excluded. As Philips finances its acquisitions with own funds, the pro forma adjustments exclude the cost of external funding incurred prior to the acquisition. The pro forma adjustments reflect the impact of the purchase-price accounting effects from January 1, 2006 to the date of acquisition. Purchase-price accounting effects primarily relate to the amortization of intangible assets

(EUR 72 million, excluding the write-off of research and development assets) and inventory step-ups (EUR 24 million).

The following table presents the year-to-date unaudited pro forma results of Philips, assuming Lifeline, Witt Biomedical, Avent and Intermagnetics had been consolidated as of January 1, 2005:

Unaudited

	January-December 2005		
	Philips Group	pro forma adjustments[1)]	pro forma Philips Group
Sales	25,445	415	25,860
Income from operations	1,558	(22)	1,536
Net income	2,868	(10)	2,858
Basic earnings per share in euros	2.29		2.29

1) Pro forma adjustments include sales, income from operations and net income from continuing operations of the acquired companies of 2005. For that purpose, sales related to the pre-existing relationship between Philips and Intermagnetics have been excluded. As Philips finances its acquisitions with own funds, the pro forma adjustments exclude the cost of external

funding ncurred in 2005. The pro forma adjustments also reflect the impact of the purchase-price accounting effects of 2005. These effects primarily relate to the amortization of intangible assets (EUR 78 million, excluding the write-off of research and development assets) and inventory step-ups (EUR 24 million).

Crypto Tec

On March 31, 2006, Philips transferred its Crypto Tec activities to Irdeto, a provider of content security, and a subsidiary of multimedia group Naspers. Irdeto purchased the CryptoTec net assets for an amount of EUR 30 million. The gain on this transaction of EUR 31 million has been reported under Other business income.

Philips Enabling Technologies

On November 6, 2006, Philips sold Philips Enabling Technologies Group (ETG) to VDL for EUR 45 million. The gain on this transaction (EUR 3 million) has been reported under Other business income.

Philips Sound Solutions

On December 31, 2006, Philips transferred its Philips Sound Solutions (PSS) business to D&M Holding for EUR 53 million. The transaction resulted in a EUR 43 million gain, reported under Other business income.

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

FEI Company

On December 20, 2006, Philips sold its 24.8 % interest in FEI Company, a NASDAQ-listed company, in a public offering. The sale provided Philips with net proceeds of EUR 154 million and a non-taxable gain of EUR 76 million. The gain is included in Results relating to equity-accounted investees.

2005

During 2005, Philips completed several divestments, acquisitions and ventures. All business combinations have been accounted for using the purchase method of accounting. Major business combinations in 2005 relate to the acquisitions of Stentor and Lumileds.The remaining business combinations, both individually and in the aggregate, were deemed immaterial in respect of the SFAS No. 141 disclosure requirements.

Sales and income from operations related to activities divested in 2005, included in the Company s consolidated statement of income for 2005, amounted to EUR 488 million and a loss of EUR 20 million, respectively.

The most significant acquisitions and divestments are summarized in the next two tables and described in the section below.

Acquisitions

	cash outflow	net assets acquired[1]	other intangible assets	goodwill
Stentor	194	(29)	108	115
Lumileds	788	(34)	268	554

1) Excluding cash acquired

Divestments

	cash inflow	net assets divested[1]	recognized gain
Connected Displays (Monitors)		(136)[2]	136
Philips Pension Competence Center	55	13	42
LG.Philips LCD	938	606	332
TSMC	770	310	460
NAVTEQ	932	179	753
Atos Origin	554	369	185
Great Nordic	67	19	48

1) Excluding cash divested

2) Represents net balance of assets received in excess of net assets divested

Stentor

In August 2005, Philips acquired all shares of Stentor, a US-based company. The related cash outflow was EUR 194 million. Stentor was founded in 1998 to provide a solution for enterprise-wide medical image and information management. Since the date of aquisition, Stentor has been consolidated within the Medical Systems sector.

Lumileds

In November 2005, Philips acquired an incremental 47.25% of Lumileds shares from Agilent, at a cost of EUR 788 million, which brought the Philips participating share to a level of 96.5%. The full business was included in the Lighting sector. In 2006, Philips acquired the remaining 3.5% of the shares.

The following table summarizes the fair value of the assets acquired and liabilities assumed with respect to the acquisition of the 47.25% additional Lumileds shares in November 2005:

	November 28, 2005
Total purchase price (net of cash)	788
Allocated to:	
Property, plant and equipment	62
Goodwill	554
Working capital	(78)
Deferred tax assets	17
Intangible assets	262
In-process R&D	6
Long-term debt	(35)
	788

The amount of purchased in-process research and development assets acquired and written off in 2005 was EUR 6 million. This amount is included in the consolidated statement of income under Research and development expenses.

Intangible assets, excluding in-process research and development, is comprised of the following:

	amount	amortization period in years
Core technology	55	8
Existing technology	91	7
Customer relationships	101	11
Luxeon trade name	14	16
Backlog	1	1
	262	

The following table presents the year-to-date unaudited pro-forma results of Philips, assuming Lumileds had been consolidated as of January 1, 2005:

Unaudited

	January-December 2005		
	Philips Group	pro forma adjustments1)	pro forma Philips Group
Sales	25,445	235	25,680
Income from operations	1,558	(20)	1,538
Net income	2,868	(20)	2,848
Basic earnings per share in euros	2.29		2.28

1) The pro forma adjustments relate to sales, income from operations and net results of Lumileds attributable to the period preceding the acquisition (EUR 42 million positive impact after tax) and also reflect the amortization of intangibles (EUR 17 million after tax), share-based compensation expense (EUR 23 million after tax), the reversal of results relating to equity-accounted investees (EUR 18 million after tax) and remaining adjustments of EUR 4 million.

Notes to the group financial statements

The following table presents the year-to-date unaudited pro-forma results of Philips, assuming Lumileds had been consolidated as of January 1, 2004:

Unaudited

			January-December 2004
	Philips Group	pro forma adjustments[1]	pro forma Philips Group
Sales	24,855	234	25,089
Income from operations	1,156	4	1,160
Net income	2,836	(7)	2,829
Basic earnings per share in euros	2.22		2.21

1) The pro forma adjustments relate to sales, Income from operations and net results of Lumileds of 2004 (EUR 52 million positive impact after taxes) and also reflect the amortization of intangibles (EUR 19 million after tax), share-based compensation expense (EUR 13 million after tax), the reversal of results relating to equity-accounted investees (EUR 23 million after tax) and remaining adjustments of EUR 4 million.

Connected Displays (Monitors)

In September 2005, Philips sold certain activities within its monitors and flat TV business to TPV Technologies (TPV), a Hong Kong listed company, for a 15% ownership interest in TPV and a convertible bond of EUR

220 million. A gain of EUR 136 million was recognized in Other business income. TPV will continue to produce monitors for Philips that will be sold under the Philips brand. Philips accounts for the investment in TPV using the equity method since the Company can exercise significant influence.

Philips Pension Competence Center

In September 2005, Philips sold the legal entities which perform the asset management function and the pension administration of the Philips Pension Fund to Merrill Lynch and Hewitt, respectively. The transactions resulted in a cash inflow of EUR 55 million and a gain of EUR 42 million, which has been reported under Other business income.

LG.Philips LCD

In July 2005, LG.Philips LCD issued 65,000,000 American Depository Shares or an equivalent of 32,500,000 shares, resulting in a dilution gain for Philips of EUR 189 million. Contemporaneously, Philips sold 9,375,000 common shares. In December 2005, Philips sold 18 million common shares. As a result of these two transactions, Philips had a cash inflow of EUR 938 million and a gain on the sales of shares of EUR 332 million, which has been reported as Results relating to equity-accounted investees. As a result of these transactions, Philips s participating share in LG.Philips LCD was reduced to 32.9%.

TSMC

In July and September 2005, Philips sold 567,605,000 common shares in the form of American Depository Shares of TSMC. This resulted in a cash inflow of EUR 770 million and a gain of EUR 460 million, which has been reported as Results relating to equity-accounted investees. Philips shareholding after these transactions was reduced from 19.0% to 16.4%. In 2005, Philips accounted for this investment using the equity method of accounting.

Great Nordic

In September 2005, Philips sold its remaining share of 3.1% in Great Nordic. This resulted in a cash inflow of EUR 67 million and a gain of EUR 48 million, which has been reported under Financial income and expenses.

Atos Origin

In July 2005, Philips sold its remaining share of 15.4% in Atos Origin. This resulted in a cash inflow of EUR 554 million and a gain of EUR 185 million, which has been reported under Financial income and expenses.

NAVTEQ

In April and May 2005, Philips sold its remaining share of 37.1% in NAVTEQ. This resulted in a cash inflow of EUR 932 million and a gain of EUR 753 million, which has been reported as Results relating to equity-accounted investees.

3

Income from operations

For information related to sales and income from operations on a geographical and segmental basis, see Information by sectors and main countries that begins on page 137 of this Annual Report.

Sales composition

	2005	2006	2007
Goods	22,912	24,107	24,270
Services	2,027	2,073	1,973
Licenses	506	502	550
	25,445	26,682	26,793

Salaries and wages

	2005	2006	2007
Salaries and wages	4,403	4,613	4,607
Pension costs	216	155	111
Other social security and similar charges:			
Required by law	593	635	634
Voluntary	(24)	104	101
	5,188	5,507	5,453

Salaries and wages include an amount of EUR 35 million (2006: EUR 78 million, 2005: EUR 106 million) relating to restructuring charges.

See note 20 for further information on pension costs.

For the remuneration of the Board of Management and Supervisory Board, please refer to note 34.

Employees

The average number of employees by category is summarized as follows (in FTEs):

	2005	2006	2007
Production	58,466	59,955	61,447
Research & development	13,659	13,227	12,804
Other	28,338	27,694	28,469
Permanent employees	100,463	100,876	102,720
Temporary employees	15,609	16,225	16,660
Continuing operations	116,072	117,101	119,380
Discontinued operations[1]	44,815	44,040	6,276

[1] Average number of discontinued operations relates to MDS, Semiconductors and MedQuist MDS was reported until June 2006 and Semiconductors until September 2006.

In many countries, employees render services under collective labor agreements, of which a significant portion expires within a year.

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Depreciation and amortization

Depreciation of property, plant and equipment and amortization of intangibles are as follows:

	2005	2006	2007
Depreciation of property, plant and equipment	542	554	562
Amortization of internal-use software	78	71	76
Amortization of other intangible assets	87	152	200
Write-off of in-process R&D	6	33	13
	713	810	851

Depreciation of property, plant and equipment includes an additional write-off in connection with the retirement of property, plant and equipment amounting to EUR 28 million (2006: EUR 20 million, 2005: EUR 13 million).

Included in depreciation of property, plant and equipment is an amount of EUR 22 million (2006: EUR 17 million, 2005: EUR 42 million) relating to impairment charges.

Depreciation of property, plant and equipment and amortization of software are primarily included in cost of sales.

In 2007, no goodwill impairments were recorded (2006: nil, 2005: nil).

Rent

Rent expenses amounted to EUR 334 million (2006: EUR 392 million, 2005: EUR 378 million).

Selling expenses

Advertising and sales promotion costs incurred totaled EUR 994 million (2006: EUR 865 million, 2005: EUR 829 million) and are included in selling expenses. Shipping and handling costs of EUR 496 million are also included (2006: EUR 558 million, 2005: EUR 497 million).

General and administrative expenses

General and administrative expenses include the costs related to management and staff departments in the corporate center, divisions and country/regional organizations, amounting to EUR 820 million (2006: EUR 882 million, 2005: EUR 758 million). Additionally, the pension costs and costs of other postretirement benefit plans relating to employees, not allocated to current division activities, amounted to a net cost of EUR 34 million (2006: EUR 87 million, 2005: EUR 16 million).

Research and development expenses

Expenditures for research and development activities amounted to EUR 1,629 million, representing 6.1% of Group sales (2006: EUR 1,659 million, 6.2% of Group sales; 2005: EUR 1,593 million, 6.3% of Group sales).

For information related to research and development expenses on a segmental basis, see the section Information by sectors and main countries that begins on page 137 of this Annual Report.

Other business income

Other business income consists of the following:

	2005	2006	2007
Results on disposal of businesses	175	103	1
Results on disposal of fixed assets	152	107	92
Remaining business income (expense)	90	24	53
	417	234	146

Results on the disposal of businesses consisted of:

	2005	2006	2007
Philips Sound Solutions		43	
CryptoTec		31	
Connected Displays (Monitors)	136	23	

Philips Pension Competence Center	42		
Other	(3)	6	1
	175	103	1

In 2007, the results on the sale of fixed assets mainly related to the sale of certain buldings in Austria and the Netherlands as well as land in the US. Remaining business income is mainly attributable to certain settlements and the finalization of several divestitures.

The result on disposal of businesses in 2006 is related mainly to the sale of the CryptoTec activities which resulted in a gain of EUR 31 million, the sale of Philips Sound Solutions PSS to D&M Holding at a gain of EUR 43 million and the sale of the monitor business in Connected Displays at a gain of EUR 23 million. The result on disposal of fixed assets is mainly related to the sale of certain real estate assets in Austria with a gain of EUR 31 million. The remaining business income consists of the settlement of certain legal claims.

The result on disposal of businesses in 2005 related mainly to the sale of certain activities within the Company s monitors and flat TV business to TPV at a gain of EUR 136 million, and the sale of asset management and pension administration activities to Merrill Lynch and Hewitt respectively at a gain of EUR 42 million (refer to note 2). The result on disposal of fixed assets in 2005 mainly related to the sale of buildings in Suresnes, France (EUR 67 million) and in the Netherlands (EUR 36 million). In 2005, remaining business income (expense) consisted of the settlement of some legal claims and some releases of provisions.

4

Restructuring charges

In 2007, a charge of EUR 37 million was recorded for restructuring. There were no goodwill impairment charges in 2007, 2006 and 2005. The components of restructuring charges recorded in 2005, 2006 and 2007 are as follows:

	2005	2006	2007
Personnel lay-off costs	106	78	35
Write-down of assets	10	5	4
Other restructuring costs	18	4	3
Release of excess provisions	(8)	(5)	(5)
	126	82	37

The restructuring charges are included in the following line items in the income statement:

	2005	2006	2007
Cost of sales	74	63	24
Selling expenses	32	8	4
G&A expenses	4	6	4
R&D expenses	16	5	5
	126	82	37

Notes to the group financial statements

The most significant new projects in 2007

Within Lighting: Restructuring of the Oss plant in the Netherlands, from mass manufacturing to a competence center, and the closure of fluorescent lamp-based LCD backlighting activities.

Within Group Management & Services: Philips Electronics North America moving from New York to Andover.

The movements in the provisions and liabilities for restructuring costs in 2007 are presented by sector as follows:

	Dec. 31, 2006	additions	utilized	released	other changes[1]	Dec. 31, 2007
Medical Systems	13	1	(14)			
DAP	6	1	(4)	(1)		2
CE	12	7	(11)			8
Lighting	45	24	(51)	(4)		14
I&EB		1				1
GMS	16	4			(1)	19
	92	38	(80)	(5)	(1)	44

[1] Other changes primarily relate to translation differences

Additions to the provisions and liabilities, and the write-down of assets in 2007 of EUR 42 million are presented by sector as follows:

	personnel costs	other costs	write-down of assets	total
Medical Systems	1			1
DAP	1			1
CE	6	1		7
Lighting	22	2	4	28
I&EB	1			1
GMS	4			4
	35	3	4	42

The most significant new projects in 2006

Within Lighting: the relocation of parts of the loss-making activities in Weert, Netherlands, to low-cost areas, the relocation in Mexico of all Juarez plant activities to the Monterrey plant and the relocation of the standard Lead in Wire business in the Netherlands (Deurne) to Poland

Within Medical Systems: the transfer of the production of SPECT cameras from Milpitas to Cleveland

Within DAP: the restructuring of the Klagenfurt site in Austria, reduction of the fixed cost base and providing a more diverse and flexible supply base.

The movements in the provisions and liabilities for restructuring costs in 2006 are presented by sector as follows:

	Dec. 31, 2005	additions	utilized	released	other changes[1)]	Dec. 31, 2006
Medical Systems		14	(1)			13
DAP	3	13	(10)			6
CE	23	12	(19)	(3)	(1)	12
Lighting	6	43	(2)	(2)		45
I&EB / GMS	30		(11)		(3)	16
	62	82	(43)	(5)	(4)	92

1) Other changes primarily relate to translation differences

Additions to the provision and liabilities, and the write-down of assets in 2006 of EUR 87 million are presented by sector as follows:

	personnel costs	other costs	write-down of assets	total
Medical Systems	13	1		14
DAP	13			13
CE	11	1		12
Lighting	41	2	5	48
I&EB / GMS				
	78	4	5	87

The most significant new projects in 2005

New projects in 2005 included the closure of the Audio/Video Innovation Centre and the restructuring of the Mobile Infotainment business in CE. Furthermore, within Lighting, further rationalization took place in Lamps through downsizing of excess capacity and transfer of production to low-wage countries. Within Innovation & Emerging businesses, a number of activities were prepared for their disentanglement or divestment The remaining restructuring projects in 2005 covered a number of smaller projects, all relating to lay-offs.

The movements in the provisions and liabilities for restructuring costs in 2005 are presented by sector as follows:

	Dec. 31, 2004	additions	utilized	released	other changes[1)]	Dec. 31, 2005
Medical Systems	2	2	(3)	(1)		
DAP	1	4	(2)			3
CE	33	67	(76)	(1)		23
Lighting	12	35	(38)	(3)		6
I&EB / GMS	59	16	(14)	(3)	(28)	30
	107	124	(133)	(8)	(28)	62

1) Other changes primarily related to translation differences

Additions to the provision and liabilities, and the write-down of assets in 2005 of EUR 134 million are presented by sector as follows:

	personnel costs	other costs	write-down of assets	total
Medical Systems	1	1		2
DAP	3	1		4
CE	54	13		67
Lighting	32	3		35
I&EB / GMS	16		10	26
	106	18	10	134

246 Reconciliation of non-US GAAP information	250 Corporate governance	258 The Philips Group in the last ten years	260 Investor information

5
Financial income and expenses

	2005	2006	2007
Interest income	87	150	236
Interest expense	(289)	(339)	(279)
Net interest expense	(202)	(189)	(43)
Income from non-current financial assets	240	334	2,697
Foreign exchange results	1	2	(1)
Other financing income (expense)	65	(119)	(40)
	306	217	2,656
	104	28	2,613

Interest income increased by EUR 86 million during 2007, mainly as a result of higher average cash balances and higher average interest rates realized during 2007, compared to 2006.
Interest expense decreased by EUR 60 million during 2007, mainly as a result of lower average debt positions and lower interest costs on derivatives related to hedging of Philips foreign currency denominated cash balances and intercompany funding positions.
In 2007, income from non-current financial assets totaled EUR 2,697 million, and included EUR 2,528 million from the sale of shares in TSMC, EUR 31 million gain on sale of shares in Nuance Communications, EUR 10 million loss on sale of shares in JDS Uniphase and a cash dividend of EUR 128 million from TSMC. In 2006, income from non-current financial assets totaled EUR 334 million, and included a cash dividend of EUR 223 million from TSMC and a gain of EUR 97 million upon designation of the TSMC shares received through a stock dividend a trading securities. In 2005, EUR 233 million of tax-exempt gains from the sale of the remaining shares in Atos Origin and Great Nordic were recognized.
In 2007, other financial charges included an impairment charge of EUR 36 million in relation to the investment in JDS Uniphase, and a EUR 12 million gain as a result of the fair value change in the conversion option embedded in the convertible bond received from TPV Technology. In 2006, other financial charges include an impairment charge of EUR 77 million in relation to the investment in TPO Display, a EUR 61 million loss as a result of the fair value change in the conversion option embedded in the convertible bond received from TPV Technology and a EUR 29 million gain as a result of increases in the fair value of the trading securities held in TSMC. In 2005, other financial charges included a EUR 53 million fair value gain on the conversion option embedded in the TPV Technology convertible bond.

6
Income taxes

The tax expense on income before tax amounted to EUR 622 million (2006: EUR 167 million, 2005: EUR 526 million).
The components of income before taxes and income tax expense are as follows:

	2005	2006	2007
Netherlands	616	444	2,770
Foreign	1,046	785	1,695
Income before taxes	1,662	1,229	4,465

Netherlands			
Current taxes	3	81	(41)
Deferred taxes	(92)	(58)	(144)
	(89)	23	(185)
Foreign:			
Current taxes	(454)	(273)	(360)
Deferred taxes	17	83	(77)
	(437)	(190)	(437)
Income tax expense	(526)	(167)	(622)

Philips operations are subject to income taxes in various foreign jurisdictions. The statutory income tax rates vary from 12.5% to 41.0%, which causes a difference between the weighted average statutory income tax rate and the Netherlands statutory income tax rate of 25.5% (2006: 29.6%; 2005: 31.5%).

A reconciliation of the weighted average statutory income tax rate to the effective income tax rate is as follows:

	2005	2006	2007
Weighted average statutory income tax rate	32.5	30.1	26.9
Tax effect of:			
Changes in the valuation allowance:			
- utilization of previously reserved loss carryforwards	(3.2)	(1.6)	(0.2)
- new loss carryforwards not expected to be realized	3.1	2.2	0.9
- additions (releases)	(9.3)	3.4	(3.5)
Non-tax-deductible impairment charges			0.2
Non-taxable income	(10.0)	(16.0)	(17.3)
Non-tax-deductible expenses	4.2	8.9	1.2
Withholding and other taxes	16.3	1.3	(0.2)
Tax rate changes	0.7	(6.5)	2.6
Tax incentives and other	(2.7)	(8.2)	3.3
Effective tax rate	31.6	13.6	13.9

The weighted average statutory tax rate declined in 2007 compared to 2006 due to change of the tax rates in certain countries, primarily due to a reduction in the Netherlands.

Notes to the group financial statements

The effective tax rate is lower than the weighted average statutory income tax rate in 2007, mainly due to non-taxable income related to dividend and the sale of shares of TSMC, and releases in the valuation allowance due to re-assessment by management, which is partly offset by reductions of deferred tax assets due to tax rate changes, and by other including re assessment of uncertain tax positions and of prior-year tax returns.

Deferred tax assets and liabilities

Deferred tax assets and liabilities relate to the following balance sheet captions:

		2006		2007
	assets	liabilities	assets	liabilities
Intangible assets	97	(330)	110	(298)
Property, plant and equipment	90	(60)	126	(55)
Inventories	158	(20)	164	(47)
Prepaid pension costs	10	(590)	18	(784)
Other receivables	70	(20)	52	(9)
Other assets	420	(20)	58	(34)
Provisions:				
- Pensions	383	(63)	444	(9)
- Restructuring	20			
- Guarantees	10		13	
-Termination benefits	20		19	
-Other postretirement benefits	100		147	
- Other provisions	460	(140)	368	(277)
Other	169	(25)	192	(35)
Total deferred tax assets/liabilities	2,007	(1,268)	1,711	(1,548)
Tax loss carryforwards (including tax credit carryforwards)	1,000		1,014	
Net deferred tax position	1,739		1,177	
Valuation allowances	(721)		(494)	
Net deferred tax assets	1,018		683	

In assessing the realizability of deferred tax assets, managements considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. In order to fully realize the deferred tax assets arising from net operating losses, the Company will need to generate future taxable income in the countries where the net operating losses were incurred. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes, as at December 31, 2007, it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowance.

The valuation allowance for deferred tax assets was EUR 494 million and EUR 721 million as of December 31, 2007 and 2006, respectively. The net changes in the total valuation allowance, due to re-assessement by management, were a decrease of EUR 227 million, a decrease of EUR 214 million and an increase of EUR 40 million for the years ended

December 31, 2007, 2006 and 2005, respectively.

At December 31, 2007, operataing loss carryforwards expire as follows:

Total	2008	2009	2010	2011	2012	2013/ 2017	later	un- limited
4,496	8	11	5	14	10	6	884	3,558

The Company also has tax credit carryforwards of EUR 77 million, which are available to offset future tax, if any, and which expire as follows:

Total	2008	2009	2010	2011	2012	2013/ 2017	later	un- limited
77	1	1		2	4	5	25	39

Classification of the deferred tax assets and liabilities is as follows:

	2006	2007
Deferred tax assets under other current assets	489	399
Deferred tax assets under other non-current assets	1,138	971
Deferred tax liabilities under provisions	(609)	(687)
	1,018	683

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

	2006	2007
Income tax receivable under current receivables	105	52
Income tax receivable under non current receivables	25	14
Income tax payable under accrued liabilities	(519)	(154)
Income tax payable under non-current liabilities	(36)	(1)

Uncertain tax positions

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainity in Income Taxes, on January 1, 2007. As a result o the implementation of FIN 48, the Company reassessed its tax positions and concluded that no cumulative effect adjustment relating to adopting FIN 48 is required on January 1, 2007. A reconciliation of the beginning and ending amount of unrecognised tax benefits is as follows:

Balance January 1, 2007	719
Additions based on tax positions related to the current year	116
Additions for tax positions of prior years	23
Reductions for tax positions of prior years for:	
Charge in judgement	(28)
Settlement during the period	(159)
Lapses of applicable statute of limitation	(1)
Currency differences	(43)
Balance at December 31, 2007	627

The estimated timing of cash payments associated with unrecognised tax positions amounting to EUR 627 million is not reliably estimable.

The total amount of unrecognized tax benefits that, if recognised, would affect the effective tax rate is EUR 577 million.

Unrecognised tax benefits including interest and penalties are accounted for as follows:

Netted against deferred tax assets	143
Netted against income tax receivable	100
Non current portion of other liabilities	429

Table of Contents

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

Estimated interest and penalties relating to unrecognized tax benefits are classified as a component of finance charges and income tax expense, respectively. During the years ended December 31, 2007, 2006, and 2005, the Company recognized EUR 14 million, EUR 6 million, and EUR 5 million respectively in interest and penalties. In addition, the Company accrued EUR 45 million and EUR 37 million in interest and penalties at December 31, 2007 and 2006, respectively.

In many cases, unrecognized tax benefits are related to tax years that remain subject to examination by the relevant tax authorities. The following table summarizes these open years by major jurisdictions:

Major jurisdiction

	Open tax years	
United States	2003	2007
United Kingdom	2001	2007
Germany	1997	2007
France	2004	2007
Netherlands	2006	2007
HongKong	2005	2007

There are no positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date.

7

Investments in equity-accounted investees

Results relating to equity-accounted investees

	2005	2006	2007
Company s participation in income and loss	513	(180)	271
Gains on sales of shares	1,545	79	514
Gains arising from dilution effects	165	14	
Investment impairment/other charges	(469)	(70)	(22)
	1,754	(157)	763

Detailed information on the aforementioned individual line items is set out below.

Company s participation in income and loss

	2005	2006	2007
LG.Philips LCD	146	(196)	260
LG.Philips Displays	(39)		
Others	406	16	11
	513	(180)	271

2007

The Company had a share in income, mainly related to LG.Philips LCD.

Philips is represented on the board of directors and continued to exercise influence by participating in the policy-making processes of LPL. Accordingly, Philips continued to apply equity accounting for LPL in 2007.

2006

The Company had a share in losses, mainly related to LG.Philips LCD.

2005

The Company had a share in income, mainly TSMC and LG.Philips LCD, and losses, mainly LG.Philips Display. The operational loss of LG. Philips Displays included restructuring costs of EUR 30 million.

Results on sales of shares

	2005	2006	2007
FEI Company		76	
NAVTEQ	753		
TSMC	460		
LG.Philips LCD	332		508
Others		3	6
	1,545	79	514

2007

In 2007, Philips sold 46,400,000 shares of LG.Philips LCD common stock, resulting in a gain of EUR 508 million. As a result of the sale, Philips shareholding in LG.Philips LCD was reduced from 32.9% to 19.9%.

2006

In 2006, Philips sold its interest of 24.8% in FEI Company (see note 2).

2005

In 2005, Philips sold its remaining 33.1 million shares in NAVTEQ, resulting in a non-taxable gain of EUR 753 million. As a result of this transaction, Philips shareholding in NAVTEQ was reduced to zero.

Results on sales of shares include a gain of EUR 460 million resulting from the sale of 567,605,000 common shares in the form of American Depository Shares in TSMC. Following the aforementioned sale of TSMC shares, Philips shareholding in TSMC was reduced to 16.4%. During 2005, the Company was represented on the board of directors and continued to exercise influence by participating in the policy-making processes of TSMC. Accordingly, the Company continued to apply equity accounting for TSMC. In January 2006, Philips influence on TSMC s financial and operating policies, including representation on the TSMC Board, was reduced. Effective January 2006, the investment was transferred to available-for-sale securities since Philips is no longer able to exercise significant influence.

In 2005, Philips sold 27,375,000 shares of LG.Philips LCD common stock, resulting in a gain of EUR 332 million. As a result of the sale, Philips shareholding in LG.Philips LCD was reduced from 40.5% to 32.9%.

Gains and losses arising from dilution effects

	2005	2006	2007
TPV		14	
LG.Philips LCD	189		
TSMC	(24)		
	165	14	

2005

The secondary offering of LG.Philips LCD of 65,000,000 American Depository Shares in July 2005 has resulted in a dilution gain of EUR 189 million, reducing Philips share from 44.6% to 40.5%. Furthermore, a loss of EUR 24 million related to the issuance of shares to employees of TSMC was included. According to TSMC s Articles of Incorporation, annual bonuses to employees have been granted, partially in shares. Philips shareholding in TSMC was diluted as a result of the shares issued to employees.

Investment impairment/other charges

	2005	2006	2007
LG.Philips Displays	(458)	(61)	(22)
Others	(11)	(9)	
	(469)	(70)	(22)

Notes to the group financial statements

2007

The voluntary support of social plans for employees impacted by the bankruptcy of certain LG.Philips Displays activities amounted to EUR 22 million.

2006

The voluntary support of social plans for employees impacted by the bankruptcy of certain LG.Philips Displays activities amounted to EUR 61 million.

2005

Investment impairment charges in 2005 related to LG.Philips Displays and a few smaller investments. In December 2005, as a result of various factors including lower demand and increased pricing pressures for CRT s, the Company concluded that its investment in LG.Philips Displays was impaired. Accordingly, the Company wrote off the remaining book value of the investment and recorded an impairment charge of EUR 126 million. Additionally, the Company recognized the accumulated foreign translation loss related to this investment of approximately EUR 290 million.

The Company also fully provided for the existing guarantee of EUR 42 million provided to LG.Philips Displays banks.

Investments in, and loans to, equity-accounted investees

The changes during 2007 are as follows:

	loans	investments	total
Investment in equity-accounted investees as of January 1, 2007	5	2,969	2,974
Changes:			
Acquisitions/additions		10	10
Sales/repayments	(4)	(1,040)	(1,044)
Share in income/value adjustments		271	271
Dividends received		(48)	(48)
Translation and exchange rate differences	(1)	(276)	(277)
Investments in equity-accounted investees as of December 31, 2007		1,886	1,886

Included in investments is EUR 404 million (2006: EUR 741 million), representing the excess of the Company s investment over its underlying equity in the net assets of equity-accounted investees. The principal amount is EUR 393 million (2006: EUR 731 million) for LG.Philips LCD.

The total carrying value of investments in, and loans to, equity-accounted investees is summarized as follows:

		2006		2007
	share-holding %	amount	share-holding %	amount
LG.Philips LCD	32.9	2,625	19.9	1,607
Other equity-accounted investees		349		279
		2,974		1,886

The fair value of Philips shareholdings in the publicly listed company LG.Philips LCD, based on quoted market prices at December 31, 2007 was EUR 2,556 million.

The investments in equity-accounted investees are mainly included in the sector Group Management & Services.

Summarized information of equity-accounted investees

Summarized financial information for the Company s investments in equity-accounted investees, on a combined basis, is presented below:

2005	2006	2007

Net sales	20,083	13,599	15,799
Income (loss) before taxes	2,269	(626)	1,304
Income taxes	117	187	(169)
Other income (loss)	(94)	(36)	(1)
Net income (loss)	2,292	(475)	1,134
Total share in net income (loss) of equity-accounted investees recognized in the consolidated statements of income	513	(180)	271

	December 31	
	2006	2007
Current assets	4,758	6,380
Non-current assets	9,788	6,406
	14,546	12,786
Current liabilities	(4,188)	(3,340)
Non-current liabilities	(3,453)	(2,429)
Net asset value	6,905	7,017
Investments in and loans to equity-accounted investees included in the consolidated balance sheet	2,974	1,886

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

8

Earnings per share

The earnings per share (EPS) data have been calculated as follows:

		2005		2006		2007
Net income						
Income from continuing operations		2,879		901		4,601
Income (loss) from discontinued operations		(11)		4,482		(433)
Net income available to holders of common shares		2,868		5,383		4,168
Weighted average number of shares		1,249,955,546		1,174,924,579		1,086,128,418
Plus incremental share from assumed conversions of:						
Options and restricted share rights	2,771,955		6,817,690		10,203,409	
Convertible debentures	602,863		1,042,061		1,103,117	
Dilutive potential common shares[1)]		3,374,818		7,859,751		11,306,526
Adjusted weighted average number of shares		1,253,330,364		1,182,784,330		1,097,434,944
Basic earnings per share in euros						
Income from continuing operations		2.30		0.77		4.24
Income (loss) from		(0.01)		3.81		(0.40)

discontinued operations			
Net income	2.29	4.58	3.84
Diluted earnings per share in euros			
Income from continuing operations	2.30	0.76	4.19
Income (loss) from discontinued operations	(0.01)	3.79	(0.39)
Net income	2.29	4.55	3.80

1) In 2007, 27 million securities (2006: 19 million, 2005: 34 million) that could potentially dilute basic EPS were not included in the computation of dilutive EPS because the effect would have been antidilutive for the periods presented.

9

Receivables

Accounts receivable, net, include installment accounts receivable of EUR 3 million (2006: EUR 8 million). Income taxes receivable (current portion) totaling EUR 52 millon (2006: EUR 105 million) are included under receivables.

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

	2005	2006	2007
Balance as of January 1	404	369	336
Additions charged to income	30	52	62
Deductions from allowance[1]	(62)	(72)	(85)
Other movements[2]	(3)	(13)	(13)
Balance as of December 31	369	336	300

1) Write-offs for which an

allowance was previously provided

2) Including the effect of translation differences and consolidation changes

10
Inventories

Inventories are summarized as follows:

	2006	2007
Raw materials and supplies	849	918
Work in process	380	391
Finished goods	1,859	2,015
Advance payments on work in process	(208)	(121)
	2,880	3,203

The amounts recorded above are net of allowances for obsolescence.

As of December 31, 2007, the carrying amount of inventories carried at fair value less cost-to-sell is EUR 190 million (2006: EUR 116 million).

11
Other current assets

Other current assets consist of a current deferred tax of EUR 399 million (2006: EUR 489 million), derivative instruments assets of EUR 275 million(2006: EUR 298 million), prepaid expenses of EUR 346 million (2006: EUR 279 million) and held-for-trading securities of EUR nil (2006: EUR 192 million).

Notes to the group financial statements

12

Other non-current financial assets

The changes during 2007 are as follows:

	available-for-sale securities	restricted liquid assets	cost-method invest-ments	other	total
Balance as of January 1, 2007	6,529	200	1,043	283	8,055
Changes:					
Reclassifications	(19)		(19)		
Acquisitions/additions	15	11	5	34	65
Sales/redemptions/reductions	(4,180)	(109)		(25)	(4,314)
Value adjustments	(607)			8	(599)
Translation and exchange differences		(1)	(2)	(21)	(24)
Balance as of December 31, 2007	1,776	101	1,027	279	3,183

Investments in available-for-sale securities

The Company s investments in available-for-sale securities consist of investments in shares of companies in various industries.

		2006		2007
	number of shares	fair value	number of shares	fair value
D&M Holdings	11,126,640	32	11,126,640	32
TSMC	4,066,046,793	6,395	1,311,490,224	1,699
		6,427		1,731

During 2007, the Company further reduced its shareholding portfolio of available-for-sale securities.

On March 12, 2007, Philips and TSMC jointly announced that the companies agreed to a multi-phased plan to facilitate an orderly exit by Philips from its shareholding in TSMC. The plan comprised a private sale transaction to long-term financial investors in Taiwan, the offering of shares through a public offering in the United States (in the form of American Depositary Shares) and the participation in stock repurchase programs initiated by TSMC. As a consequence Philips disposed of EUR 2,755 million TSMC shares and realized an aggregate gain of EUR 2,528 million, which was presented under Financial income and expense. As of December 31, 2007, Phillips owns 4.96% of TSMC s share capital with a current market value of EUR 1,699 million.

On May 17, 2007, Philips sold its remaining stake of approximately 2.5% (4,914,875 common shares) of the issued share capital in US-based JDS Uniphase. On September 14, 2007, Philips sold its stake of approximately 2.5%

(4,587,333 common shares) in US-based Nuance Communications. The results on these transactions were recognized under Financial income and expenses.

Included in other non-current financial assets is a convertible bond issued to the Company by TPV with a total fair value of EUR 190 million as at December 31, 2007. The bond has a maturity date of September 5, 2010, with an option to convert the bond into shares of TPV during the period September 5, 2008 until maturity.

Cost-method investments

The major cost-method investment is NXP, for an amount of EUR 854 million, of which the Company holds 19.9% of the cumulative preferred shares and 17.5% of the common shares. The interest in NXP resulted from the sale of a majority stake in the Semiconductors division in September 2006. The Company performed an impairment review on the cost of the investment in NXP and concluded that no impairment needs to be recognized at December 31, 2007.

In June 2006, the merger of MDS with Toppoly was completed. As a consequence of the transaction, Philips holds a 17.4% stake in TPO, valued at amortized cost of EUR 103 million, net of an impairment of EUR 77 million.

13

Non-current receivables

Non-current receivables include receivables with a remaining term of more than one year, and the non-current portion of income taxes receivable amounting to EUR 14 million (2006: EUR 25 million).

14

Other non-current assets

Other non-current assets in 2007 are comprised of prepaid pension costs of EUR 2,703 million (2006: EUR 2,262 million), deferred tax assets of EUR 971 million (2006: EUR 1,138 million) and prepaid expenses of EUR 52 million (2006: EUR 47 million).

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

15
Property, plant and equipment

	land and buildings	machinery and installations	lease assets	other equipment	prepayments and construction in progress	no longer productively employed	total
Balance as of January 1, 2007:							
Cost	2,182	3,303	74	1,552	393	20	7,524
Accumulated depreciation	(911)	(2,224)	(50)	(1,242)		(13)	(4,440)
Book value	1,271	1,079	24	310	393	7	3,084
Changes in book value:							
Capital expenditures	113	283	30	235			661
Retirements and sales	(6)	(24)	(1)	(6)	(42)	(3)	(82)
Depreciation	(76)	(235)	(12)	(189)			(512)
Write-downs and impairments	(7)	(15)					(22)
Translation differences	(15)	(8)	(3)	(14)	(5)		(45)
Changes in consolidation	88	(6)	2	15	(3)		96
Total changes	97	(5)	16	41	(50)	(3)	96
Balance as of December 31, 2007:							
Cost	2,303	3,395	88	1,732	343	13	7,874
Accumulated depreciation	(935)	(2,321)	(48)	(1,381)		(9)	(4,694)
Book value	1,368	1,074	40	351	343	4	3,180

Land with a book value of EUR 148 million, as at December 31, 2007 (2006: EUR 141 million) is not depreciated.
The expected useful lives as of December 31, 2007, were as follows:

Buildings	from 14 to 50 years
Machinery and installations	from 4 to 15 years
Lease assets	from 3 to 10 years
Other equipment	from 3 to 10 years

Capital expenditures include capitalized interest related to construction in progress amounting to EUR 5 million in 2007 (2006: EUR 9 million).

Notes to the group financial statements

16
Intangible assets excluding goodwill

The changes during 2007 were as follows:

	software	other intangible assets	total
Balance as of January 1, 2007:			
Cost	552	2,199	2,751
Accumulated amortization	(386)	(552)	(938)
Book value	166	1,647	1,813
Changes in book value:			
Acquisitions/additions	125	704	829
Amortization/deductions	(76)	(200)	(276)
Translation differences	(11)	(200)	(211)
Other	7	(8)	(1)
Total changes	45	296	341
Balance as of December 31, 2007:			
Cost	615	2,629	3,244
Accumulated amortization	(404)	(686)	(1,090)
Book value	211	1,943	2,154

Other intangible assets in 2007 consist of:

	gross	January 1 accumulated amortization	gross	December 31 accumulated amortization
Marketing-[1] related	301	(47)	168	(30)
Customer- related	874	(180)	1,042	(182)
Contract- based	54	(9)	33	(10)
Technology-based	584	(239)	735	(374)
Patents and trademarks[1]	386	(77)	651	(90)
	2,199	(552)	2,629	(686)

1) In 2007, a reclassification was made of EUR 100 million following finalization of

the purchase
price accounts
of Lifeline.

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

2008	181
2009	180
2010	176
2011	149
2012	127

The expected weighted average remaining life of other intangibles is 6.4 years as of December 31, 2007.

The additions acquired through business combinations in 2007 consist of the acquired intangible assets of Partners in Lighting of EUR 217 million and Color Kinetics of EUR 187 million.

Other intangible assets include EUR 356 million representing the trademarks and trade names Lifeline and Avent, which were acquired in 2006 and have indefinite useful lives. These brands are used together with the Philips brand in a dual branding strategy. Therefore these brands are not amortized but tested for impairment annually or whenever there is an indication that the brand may be impaired.

The unamortized costs of computer software to be sold, leased or otherwise marketed amounted to EUR 63 million (2006: EUR 57 million). The amounts charged to the income statement for amortization or impairment of these capitalized computer software costs amounted to EUR 20 million (2006: EUR 18 million).

17
Goodwill

The changes in 2006 and 2007 were as follows:

	2006	2007
Balance as of January 1:		
Cost	2,570	3,853
Accumulated amortization/impairments	(142)	(130)
Book value	2,428	3,723
Acquisitions	1,590	810
Translation differences	(295)	(398)
Balance as of December 31:		
Cost	3,853	4,249
Accumulated amortization/impairments	(130)	(114)
Book value	3,723	4,135

The key assumptions used in the annual impairment test are growth of sales and gross margin, together with the rates used for discounting the forecast cash flows. The discount rates are determined for each reporting unit (one level below sector level) and range from 8.0% to 11.3%, with an average of 9.7% for the Group. Sales and gross margin growth are based on management s internal forecasts for four years that are extrapolated for another five years with reduced growth rates, after which a terminal value is calculated in which growth rates are reduced to a level of 0% to 3.5%.

Acquisitions in 2007 include the goodwill paid on the acquisition of Partners in Lighting for EUR 297 million, Color Kinetics for EUR 357 million and several smaller acquisitions. In addition goodwill changed due to the finalization of purchase price accounting related to acquisitions in prior years.

Acquisitions in 2006 include the goodwill paid on the acquisition of Lifeline for EUR 341 million, Witt Biomedical for EUR 90 million, Avent for EUR 344 million and Intermagnetics for EUR 733 million (adjusted for the effects of the final purchase price allocation completed in 2007), and several smaller acquisitions.

Please refer to Information by sectors and main countries that begins on page 138 of this Annual Report for a specification of goodwill by sector.

246 Reconciliation of non-US GAAP information | 250 Corporate governance | 258 The Philips Group in the last ten years | 260 Investor information

18

Accrued liabilities

Accrued liabilities are summarized as follows:

	2006	2007
Personnel-related costs:		
- Salaries and wages	492	433
- Accrued holiday entitlements	185	178
- Other personnel-related costs	120	169
Fixed-assets-related costs:		
- Gas, water, electricity, rent and other	71	62
Taxes:		
- Income tax payable	519	154
- Other taxes payable	2	12
Communication & IT costs	47	31
Distribution costs	64	109
Sales-related costs:		
- Commissions payable	65	43
- Advertising and marketing-related costs	119	66
- Other sales-related costs	180	206
Material-related accruals	167	134
Interest-related accruals	118	110
Deferred income	478	564
Derivative instruments liabilities note 35	101	144
Other accrued liabilities	569	569
	3,297	2,984

Please refer to note 6 for a specification of income tax payable.

19

Provisions

Provisions are summarized as follows:

		2006		2007
	long-term	short-term	long-term	short-term
Provision for defined-benefit plans (see note 20)	787	91	745	68
Other postretirement benefits (see note 21)	337	36	390	23
Postemployment benefits and obligatory severance payments	92	50	113	13
Deferred tax liabilities (see note 6)	488	121	686	1
Product warranty	17	348	133	190
Loss contingencies (environmental remediation and product liability)	483	93	432	49
Other provisions	213	137	228	33
	2,417	876	2,727	377

Product warranty

The provision for product warranty reflects the estimated costs of replacement and free-of-charge services that are expected to be incurred by the Group with respect to products sold. The changes in the provision for product warranty are as follows:

	2005	2006	2007
Balance as of January 1	353	378	365
Changes:			
Additions	491	438	360
Utilizations	(472)	(443)	(369)
Releases	(7)		(6)
Translation differences	20	(13)	(16)
Changes in consolidation	(7)	5	(11)
Balance as of December 31	378	365	323

Loss contingencies (environmental remediation and product liability)

This provision includes accrued losses recorded with respect to environmental remediation and product liability (including asbestos) obligations which are probable and reasonably estimatable. Please refer to note 27.

The changes in this provision are as follows:

	2005	2006	2007
Balance as of January 1	275	287	576
Changes:			
Additions	27	370	16
Utilizations	(43)	(39)	(66)
Releases	(3)	(5)	(1)
Translation differences	31	(37)	(44)
Balance as of December 31	287	576	481

Postemployment benefits and obligatory severance payments

The provision for postemployment benefits covers benefits provided to former or inactive employees after employment but before retirement, including salary continuation, supplemental unemployment benefits and disability-related benefits.

The provision for obligatory severance payments covers the Company s commitment to pay employees a lump sum upon the employee s dismissal or resignation. In the event that a former employee has passed away, the Company may have a commitment to pay a lump sum to the deceased employee s relatives.

Other provisions

Other provisions include provisions for employee jubilee funds totaling EUR 79 million (2006: EUR 88 million) and expected losses on existing projects/orders totaling EUR 14 million (2006: EUR 14 million).

Notes to the group financial statements

20

Pensions

Employee pension plans have been established in many countries in accordance with the legal requirements, customs and the local situation in the countries involved. The majority of employees in Europe and North America are covered by defined-benefit pension plans. The benefits provided by these plans are based on employees years of service and compensation levels. The measurement date for all defined-benefit pension plans is December 31.

For funded plans the Company makes contributions, as necessary, to provide assets sufficient to meet the benefits payable to defined-benefit pension plan participants. These contributions are determined based upon various factors, including funded status, legal and tax considerations as well as local customs.

	2005	2006	2007
Summary of pre-tax costs for pension plans and retiree healthcare plans			
Defined benefit plans	157	75	27
Defined contribution plans incl. multi-employer plans	56	80	84
Medical retiree cost (see note 21)	(101)	39	36
	112	194	147

The Company funds certain defined-benefit pension plans as claims are incurred. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for both funded and unfunded defined-benefit pension plans with accumulated benefit obligations in excess of plan assets are included in the table below:

	2006	2007
Projected benefit obligation	3,791	4,476
Accumulated benefit obligation	3,600	4,356
Fair value of plan assets	2,543	3,445

The table below provides a summary of the changes in the pension benefit obligations and defined pension plan assets for 2007 and 2006 and a reconciliation of the funded status of these plans to the amounts recognized in the consolidated balance sheets:

			2006			2007
	Netherlands	other	total	Netherlands	other	total
Projected benefit obligation						
Projected benefit obligation at beginning of year	12,936	8,198	21,134	12,396	8,014	20,410
Service cost	198	129	327	147	118	265
Interest cost	531	411	942	521	399	920
Employee contributions	1	9	10		4	4
Actuarial (gains) losses	(325)	299	(26)	(670)	(86)	(756)
Plan amendments						