Accounting principles

The consolidated financial statements are prepared on a basis consistent with generally accepted accounting principles in the Netherlands ('Dutch 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. ('Royal Philips Electronics' or 'the Company') and companies that are majority-owned or otherwise controlled. Minority interests are disclosed as share of other group equity in group income in the consolidated statement of income and as other group equity in the consolidated balance sheet. Intercompany transactions and balances have been eliminated.
Investments in companies in which Royal Philips Electronics exerts significant influence, but does not control the financial and operating decisions, are accounted for by the equity method. Generally, significant influence 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 unconsolidated companies in the consolidated statement of income.
Investments in companies in which Royal Philips Electronics does not exert significant influence are carried at cost or, if a long-term impairment exists, at lower net realizable value.

Foreign currencies

The financial statements of foreign operations are translated into the Dutch guilder, the Company's reporting currency. Assets and liabilities are translated using the exchange rates on the respective balance sheet dates. Income and expense items are translated based on the average rates of exchange for the periods involved. The resulting translation adjustments are charged or credited to stockholders' equity. Cumulative translation adjustments are recognized as income or expense upon disposal of foreign operations.
The functional currency of foreign operations is generally the local currency, unless the primary economic environment requires the use of another currency. However, when foreign operations conduct business in economies considered to be highly inflationary, they record transactions in a designated functional currency (usually the US dollar) instead of their local currency.
Gains and losses arising from the translation or settlement of foreign-denominated monetary assets and liabilities into the local currency are recognized in income in the period in which they arise. However, currency differences on intercompany loans which have the nature of a permanent investment are accounted for in stockholders' equity.

Derivative financial instruments

The Company uses derivative financial instruments principally in the management of its foreign currency risks. A derivative financial instrument is recognized by the Company on its balance sheet at the value of the consideration given or received for it. After initial recognition the Company measures derivatives at their fair value. Gains or losses arising from changes in the fair value of a derivative are recognized in the income statement for the period in which they arise to the extent they hedge an asset or liability that has been recognized on the balance sheet. Unrealized gains and losses relating to derivative financial instruments entered into as hedges of firm commitments are deferred until the hedged transactions have been reflected in the accounts. Deferred gains and losses on hedges of firm commitments are reported in the balance sheet as deferred income under stockholders' equity.

Cash and cash equivalents

Cash and cash equivalents include all cash balances and short-term highly liquid investments that are readily convertible to known amounts of cash. They are stated at face value.

Receivables

Receivables are carried at face value, net of allowances for doubtful accounts.

Inventories

Inventories are valued at the lower of cost or market value less advance payments on work in process. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor, fixed and variable production overheads, product development and process development costs, taking into account the stage of completion. The cost of inventories is determined using the first-in, first-out (FIFO) method. Provision is made for obsolescence.

Other non-current assets

Loans receivable are carried at face value, less a provision for doubtful accounts. Investments in companies (securities) with a restriction on the resale of these securities for a period of one year or more, are accounted for at cost, being the fair value upon receipt of the shares. These are presented as other non-current financial assets.

Property, plant and equipment

Property, plant and equipment is carried 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 deducted from the cost of the related asset. Depreciation is calculated using the straight-line method over the expected economic life of the asset. Depreciation of special tooling costs is based on the expected future economic benefit of these tools. In the event that an impairment in value of fixed assets occurs, the loss is charged to income. Gains and losses on the sale of property, plant and equipment are included in other business income.

Intangible assets

Intangible assets include goodwill arising from acquisitions made after January 1, 1992. Goodwill is amortized using the straight-line method over its estimated economic life, not to exceed forty years.

Certain acquired intangible assets other than goodwill ('in-process R&D') are expensed in the period of acquisition.

Patents and trademarks acquired from third parties are capitalized and amortized over their remaining lifetime.

If events or circumstances indicate that the carrying amount of intangible assets may not be recoverable, an impairment test is applied based upon an assessment of future cash flows to ensure that they are appropriately valued.

Costs of research and development are expensed in the period in which they are incurred.

Provisions

Provisions are recognized by the Company for liabilities and losses which have been incurred as of the balance sheet date and for which the amount is uncertain but can be reasonably estimated. Additionally, the Company records provisions for losses which are expected to be incurred in the future but which relate to contingencies that exist as of the balance sheet date.

Provisions are stated at face value, with the exception of provisions for postretirement benefits (including pensions) and severance payments in certain countries where such payments are made in lieu of pension benefits; those provisions are stated at the present value of the future obligations.

Debt and other liabilities

Debt and liabilities other than provisions are stated at face value.

Revenue recognition

Sales are generally recognized at the time the product is delivered to the customer, net of sales taxes, customer discounts, rebates and similar charges. Service revenue is recognized over the contractual period or as services are rendered. Revenues from long-term contracts are recognized in accordance with the percentage of completion method. Provision for estimated contract losses, if any, is made in the period that such losses are determined. Royalty income is recognized on an accrual basis. Government grants other than those relating to assets, are recognized as income to the extent that it is more likely than not that these grants will be received.

Financial income and expenses

Interest income and interest expense are recognized on an accrual basis.

Income taxes

Income tax expense is based on pre-tax financial accounting income. 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 upon 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 if it is more likely than not that the asset will be realized. Deferred tax assets and liabilities are not discounted. Deferred tax liabilities for withholding taxes are only taken into consideration in situations where the income of subsidiaries is to be paid out as dividends in the near future.

Benefit accounting

The Company accounts for the cost of pension plans and postretirement benefits other than pensions substantially 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 plans are funded with plan assets that have been segregated and restricted in a trust to provide for the pension benefits to which the Company has committed itself. When plan assets have not been segregated by the Company or in such cases in which the Company is required to make additional pension payments, the Company recognizes a provision for such amounts. The costs related to defined benefit pension plans are in general terms the aggregate of the compensation cost of the benefits promised, interest cost resulting from deferred payment of those benefits and, in the case of plan assets segregated in a trust, the results on the amounts of the invested plan assets. The cost component of the pension benefit corresponding to each year of service is the actuarial present value of the benefit earned in that year. In principle the same amount of pension benefit is attributed to each year of service. If and to the extent that as of the beginning of the year, the present value of the projected benefit obligation differs from the market value of the plan assets or the existing pension provision, the difference is amortized over the average remaining service period of active employees. In the event, however, that at any date the accumulated benefit obligation calculated as the present value of the benefits attributed to employee service rendered prior to that date and based on current and past compensation levels would be higher than the market value of the plan assets or the existing level of the pension provision, the difference is immediately charged to income.

In certain countries the Company also provides postretirement benefits other than pensions to various employees. The cost relating to such plans consists of the present value of the benefits attributed on equal basis to each year of service, and interest cost on the accumulated postretirement benefit obligation, which is a discounted amount. The transition obligation is being recognized through charges to earnings over a twenty-year period beginning in 1993 in the US and in 1995 for all other plans.

Stock-based compensation

The Company accounts for stock-based compensation using the intrinsic value method in accordance with Dutch GAAP which is also in conformity with US Accounting Principles Board Opinion No. 25, 'Accounting for Stock Issued to Employees'. The Company has adopted the pro forma disclosure requirements of SFAS No. 123, 'Accounting for Stock-Based Compensation'.

Discontinued operations

Any gain or loss from disposal of a segment of a business (product sector), together with the results of these operations until the date of disposal, are reported separately as discontinued operations. The financial information of a discontinued segment of business is excluded from the respective captions in the consolidated financial statements and related notes. Comparative figures for prior periods are restated accordingly.

Extraordinary income and losses

Extraordinary items include income or losses arising from the disposal of a line of activity or closures of substantial production facilities within a segment of business as well as significant gains or losses arising from disposals of interests in unconsolidated companies.

Risks and uncertainties

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 with generally accepted accounting principles. Changes in such estimates and assumptions may affect amounts reported in future periods.

Cash flow statements

Cash flow statements have been prepared under the indirect method in accordance with Dutch GAAP, which is substantially similar to the requirements of SFAS No. 95 'Statement of Cash flows'. Cash flows in foreign currencies have been translated into Dutch guilders using the average rates of exchange for the periods involved.

Consolidated statements of income of the Philips Group

in millions of Dutch guilders unless otherwise stated

		1998	1997*	1996*
	Sales	**67,122**	65,358	59,707
	Direct cost of sales	**(53,155)**	(50,780)	(47,574)
	Gross income	**13,967**	14,578	12,133
	Selling expenses	**(9,655)**	(8,950)	(9,195)
	General and administrative expenses	**(2,495)**	(2,036)	(1,774)
	Other business income	**418**	290	330
	Restructuring charges	**(726)**	(105)	(565)
2	**Income from operations**	**1,509**	3,777	929
3	Financial income and expenses	**(686)**	(703)	(890)
	Income before taxes	**823**	3,074	39
4	Income taxes	**(91)**	(607)	15
	Income after taxes	**732**	2,467	54
5	Results relating to unconsolidated companies	**86**	206	320
	Group income	**818**	2,673	374
6	Share of other group equity in group income	**374**	39	(96)
	Income from continuing operations	**1,192**	2,712	278
1	**Discontinued operations:**			
	Income from discontinued operations (less applicable income taxes of NLG 166, NLG 355 and NLG 244 million for 1998, 1997 and 1996, respectively)	**462**	579	445
	Gain on disposal of discontinued operations (no tax effect)	**10,675**	–	–
7	**Extraordinary items – net**	**1,010**	2,442	(1,313)
8	**Net income (loss)**	**13,339**	5,733	(590)

Earnings per share

	1998	1997*	1996*
Weighted average number of common shares outstanding (after deduction of treasury stock) during the year	**360,056,076**	349,397,603	341,847,784
Basic earnings per common share in NLG:			
- income from continuing operations	**3.31**	7.76	0.81
- income from discontinued operations	**1.28**	1.66	1.30
- gain on disposal of discontinued operations	**29.65**	–	–
- extraordinary items – net	**2.81**	6.99	(3.84)
- net income (loss)	**37.05**	16.41	(1.73)
Diluted earnings per common share in NLG:			
- income from continuing operations	**3.29**	7.61	0.81
- income from discontinued operations	**1.27**	1.63	1.30
- gain on sale of discontinued operations	**29.41**	–	–
- extraordinary items – net	**2.78**	6.85	(3.84)
- net income (loss)	**36.75**	16.09	(1.73)
Dividend per common share in NLG	**2.20****	2.00	1.60

The dilution effects on earnings per share are only taken into consideration if this does not result in an improvement in income per share or in a reduction in loss per share (year 1996).

* Restated to reflect the sale of PolyGram N.V. and to present the Philips Group accounts on a continuing basis for all years presented.

** Subject to approval by the Annual General Meeting of Shareholders on March 25, 1999.

Consolidated balance sheets of the Philips Group as of December 31

in millions of Dutch guilders unless otherwise stated

The 1998 consolidated balance sheet includes a liability for the proposed dividend, which is subject to approval by the Annual General Meeting of Shareholders on March 25, 1999.

Assets

Note			1998		1997*
	Current assets				
9	Cash and cash equivalents		**14,441**		3,079
10	Receivables:				
	- Accounts receivable, net	**9,566**		10,399	
	- Other receivables	**1,681**		1,197	
	- Prepaid expenses	**745**		444	
			11,992		12,040
11	Inventories		**9,419**		9,966
	Total current assets		**35,852**		25,085
	Non-current assets				
5	Unconsolidated companies:				
	- Investments	**2,104**		2,469	
	- Loans	**45**		55	
	- Net assets of discontinued operations (PolyGram N.V.)	**–**		3,265	
			2,149		5,789
12	Other non-current financial assets		**4,101**		674
13	Non-current receivables:				
	- Accounts receivable	**630**		176	
	- Other receivables	**454**		366	
	- Prepaid expenses	**3,146**		3,553	
			4,230		4,095
14	Property, plant and equipment:				
	- At cost	**36,741**		37,161	
	- Less: accumulated depreciation	**(22,253)**		(21,878)	
			14,488		15,283
15	Intangible assets		**1,221**		468
	Total non-current assets		**26,189**		26,309
	Total		**62,041**		51,394

* Restated to reflect the sale of PolyGram N.V. and to present the Philips Group accounts on a continuing basis for all years presented.

Liabilities and stockholders' equity

Note			1998		1997*
	Current liabilities				
	Accounts and notes payable:				
	- Trade creditors	**6,469**		6,333	
	- Unconsolidated companies	**27**		67	
			6,496		6,400
16	Accrued liabilities		**6,396**		6,078
17	Short-term provisions		**2,128**		2,066
18	Other current liabilities		**2,047**		1,465
	Dividend payable		**794**		716
19	Short-term debt		**1,765**		1,810
	Total current liabilities		**19,626**		18,535
	Non-current liabilities				
20	Long-term debt		**6,140**		7,072
17	Long-term provisions		**4,450**		5,098
	Total non-current liabilities		**10,590**		12,170
21	Commitments and contingent liabilities				
	Group equity				
6	Other group equity		**533**		1,232
	Stockholders' equity:				
	Priority shares, par value NLG 5,000 per share:				
	Authorized and issued 10 shares				
	Preference shares, par value NLG 10 per share:				
	Authorized 499,995,000 shares				
	Issued – none –				
	Common shares, par value NLG 10 per share:				
	Authorized 500,000,000 shares				
	- Issued 368,494,824 shares				
	- (364,777,116 in 1997)	**3,685**		3,648	
22	Share premium	**4,019**		3,943	
22	Other reserves	**23,588**		11,866	
			31,292		19,457
	Total		**62,041**		51,394

Consolidated statements of cash flows of the Philips Group

in millions of Dutch guilders

	1998	1997*	1996*
Cash flows from operating activities:			
Net income (loss)	**13,339**	5,733	(590)
Adjustments to reconcile net income to net cash provided by operating activities:			
Income from discontinued operations	**(462)**	(579)	(445)
Net gain on disposal of discontinued operations	**(10,675)**	–	–
Depreciation and amortization	**4,164**	3,520	3,405
Net gain on sale of investments	**(1,604)**	(3,070)	(255)
Decrease (increase) in working capital, net of effects from acquisitions and sales	**600**	1,137	(556)
Decrease (increase) in non-current receivables	**95**	(341)	(390)
(Decrease) increase in provisions	**(390)**	(246)	833
Results relating to unconsolidated companies	**(68)**	–	(283)
Share of other group equity in group income	**(382)**	(100)	24
Other items	**98**	1,019	265
Net cash provided by operating activities	**4,715**	7,073	2,008
Cash flows from investing activities:			
Capital expenditures on property, plant and equipment	**(3,600)**	(3,585)	(4,815)
Proceeds from disposals of property, plant and equipment	**527**	496	354
Purchase of other non-current financial assets	**(149)**	(383)	(258)
Proceeds from other non-current financial assets	**291**	527	339
Purchase of businesses, net of cash acquired	**(1,910)**	(576)	(794)
Proceeds from sale of interests in businesses	**1,666**	3,621	1,128
Net cash (used for) provided by investing activities	**(3,175)**	100	(4,046)
Cash flows (before financing activities)	**1,540**	7,173	(2,038)
Cash flows from financing activities:			
(Decrease) increase in short-term debt	**(164)**	(3,311)	1,478
Principal payments on long-term debt	**(1,245)**	(2,597)	(1,855)
Proceeds from issuance of long-term debt	**427**	886	2,560
Payments of conversion certificates	**–**	(33)	–
Effect of other financial transactions	**252**	–	–
Treasury stock transactions	**(345)**	(251)	77
Dividends paid	**(719)**	(557)	(549)
Net cash (used for) provided by financing activities	**(1,794)**	(5,863)	1,711
Cash (used for) provided by continuing operations	**(254)**	1,310	(327)

* Restated to reflect the sale of PolyGram N.V. and to present the Philips Group accounts on a continuing basis for all years presented.

Consolidated statements of cash flows of the Philips Group (continued)

	1998	1997*	1996*
Cash (used for) provided by continuing operations	**(254)**	1,310	(327)
Effect of changes in exchange rates and consolidations on cash positions	**67**	(89)	(123)
Net cash provided by (used for) discontinued operations	**202**	407	(65)
Net cash from disposal of discontinued operations	**11,347**	–	–
Cash and cash equivalents at beginning of year	**3,079**	2,145	2,660
Cash and cash equivalents at end of year	**14,441**	3,773	2,145
Of which: cash and cash equivalents discontinued operations	**–**	694	414
Cash and cash equivalents continuing operations	**14,441**	3,079	1,731

Supplemental disclosures to consolidated statements of cash flows:

	1998	1997*	1996*
Decrease (increase) in working capital net of effects from acquisitions and sales:			
Increase in accounts receivable and prepaid expenses	**(292)**	(56)	(1,798)
(Increase) decrease in inventories	**(133)**	(394)	857
Increase in accounts payable and accrued expenses	**1,025**	1,587	385
	600	1,137	(556)
Net cash paid during the year for:			
Interest	**536**	748	767
Income taxes	**440**	340	313
Additional common stock issued upon conversion of long-term debt	**56**	143	8
Net gain on sale of investments:			
Cash proceeds from the sale of investments (property, plant and equipment and interests in companies)	**2,492**	4,644	1,827
Book value of these investments taking into account the effects of related goodwill and translation differences	**(888)**	(1,574)	(1,572)
	1,604	3,070	255
Non-cash investing and financing information:			
Assets received in lieu of cash	**3,742**	82	–
Treasury stock transactions:			
Shares acquired	**(711)**	(781)	(217)
Shares sold	**260**	206	54
Exercise warrants/stock options	**106**	324	240

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

in millions of Dutch guilders, unless otherwise stated

	number of shares * outstanding	number of shares * issued	issued, paid-up capital	share premium	other reserves	total
Balance as of December 31, 1995	341,756,174	345,062,054	3,451	3,474	7,130	14,055
Issued in exchange for:						
- convertible debentures and on exercise						
of conversion certificates		190,569	2	6		8
- stock options		1,422,330	14	29		43
- warrants		5,804,609	58	139		197
Net loss for the year					(590)	(590)
Dividend payable					(555)	(555)
Treasury stock transactions					(163)	(163)
Translation differences and other changes					961	961
Balance as of December 31, 1996	347,080,144	352,479,562	3,525	3,648	6,783	13,956
Issued in exchange for:						
- convertible debentures and on exercise						
of conversion certificates		1,544,714	15	79		94
- stock options				(42)		(42)
- warrants		10,752,840	108	258		366
Net income for the year					5,733	5,733
Dividend payable					(716)	(716)
Treasury stock transactions					(493)	(493)
Translation differences and other changes					559	559
Balance as of December 31, 1997	357,949,491	364,777,116	3,648	3,943	11,866	19,457
Issued in exchange for:						
- convertible debentures and on exercise						
of conversion certificates		80,847	1	6	49	56
- stock options				(17)		(17)
- warrants		3,636,861	36	87		123
Net income for the year					13,339	13,339
Dividend payable					(794)	(794)
Treasury stock transactions					(451)	(451)
Translation differences and other changes					(421)	(421)
Balance as of December 31, 1998	360,690,217	368,494,824	3,685	4,019	23,588	31,292

* par value NLG 10 per share

Notes to the consolidated financial statements of the Philips Group

all amounts in millions of Dutch guilders unless otherwise stated

Introduction

The financial statements of Koninklijke Philips Electronics N.V. (the 'Parent Company') are included in the statements of the Philips Group. The unconsolidated statements of income of Koninklijke Philips Electronics N.V. therefore reflect only the net after-tax income from affiliated companies and other income after taxes.

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

Presentation balance sheet and income statement

In 1997, the Company changed the format of its consolidated balance sheet presentation. The primary reason for the change was to accommodate the expectations of foreign, mainly US shareholders, who represent a large percentage of the shareholders in the Company. In light of this, the Company decided to present its consolidated balance sheet and income statement more in line with a presentation that is common practice in the United States. Under the new format, the order of presentation of assets and liabilities is based on the degree of liquidity.

The most important change refers to certain items which in the previous format were included in current receivables and have been reclassified to long-term receivables under the new format, to better reflect the nature of the assets and to better present working capital and the proportion of current assets that is not current. The current balance sheet presentation is somewhat different from the one used under Dutch regulations.

1 Acquisitions and divestitures

PolyGram

On May 21, 1998, Philips, PolyGram N.V. ('PolyGram') and The Seagram Company Ltd. ('Seagram') announced that they had reached an agreement that Seagram would acquire all outstanding shares of PolyGram for a consideration of NLG 117 in cash for each PolyGram share or, at shareholders' election, a mixture of cash and Seagram shares based on an exchange ratio of 1.4012 Seagram shares for each PolyGram share. On June 22, 1998, the price was reduced to NLG 115 or a mixture of cash and Seagram shares based on an exchange ratio of 1.3772 Seagram shares for each PolyGram share. This reduction reflected the lower than expected financial results of PolyGram during the second quarter of 1998. Philips also agreed to hold the Seagram shares for at least two years from the closing of the transaction.

On December 10, 1998, Seagram acquired substantially all of the outstanding PolyGram shares. On that date, Philips received NLG 11,531 million in cash and 47,831,952 Seagram shares representing approximately 12% of the outstanding Seagram shares. The sale of PolyGram resulted in a gain of NLG 10,675 million, or NLG 29.65 per share, free of taxes. In order to gain insight into the Company's cash flows, earnings capacity and financial position, the information about discontinued operations has been segregated from the information about continuing operations. The financial information relating to PolyGram, being a separate product sector, has been excluded from the respective captions in the consolidated financial statements and related notes, and is reported separately up to the date of sale. Comparative information for prior periods has been restated by separating continued and discontinued operations retrospectively.

Summarized financial information for PolyGram is as follows:

	1998*	1997	1996
Sales	**10,617**	11,095	9,488
Costs and expenses	**(9,734)**	(9,912)	(8,605)
Income from operations	**883**	1,183	883
Financial income and expenses	**(57)**	(17)	(8)
Income before taxes	**826**	1,166	875
Income taxes	**(166)**	(355)	(244)
Income after taxes	**660**	811	631
Results unconsolidated companies/share other group equity	**(198)**	(232)	(186)
Net income (Philips' share)	**462**	579	445
Net cash provided by operating activities		645	630
Net cash used for investing activities		(235)	(456)
Net cash used for financing activities		(3)	(239)

	Dec. 31, 1997	Dec. 31, 1996
Current assets	6,580	5,229
Total assets	11,312	9,434
Current liabilities	5,451	4,442
Total liabilities	8,047	6,794
Net assets of discontinued operations	3,265	2,640

* Until December 10, 1998

Joint venture Philips/Lucent

Effective September 27, 1998, Philips and Lucent Technologies terminated their joint venture, Philips Consumer Communications (PCC).
Philips, which owned 60% of the venture, and Lucent, which owned 40%, each regained control of their originally contributed assets. The joint venture was formed on October 1, 1997.

The assets over which Philips regained control include its wireless business, which is mainly GSM, its wired business outside North America, and paging. Approximately 5,000 PCC employees returned to Philips, approximately 8,600 returned to Lucent.

The 1998 income from operations incorporated losses related to the unwinding of the joint venture, including a write down of obsolete inventories (NLG 351 million), and the subsequent restructuring of the returned PCC activities (NLG 475 million).

Summarized financial information for the PCC joint venture, included in Philips' consolidated financial statements, is as follows:

	9 months 1998	3 months 1997
Sales	**3,032**	1,257
Loss from operations	**(770)**	(121)
Loss before income taxes	**(771)**	(120)
Net loss	**(483)**	(66)
Net cash (used for) provided by operating activities	**(832)**	133
Net cash used for investing activities	**(105)**	(69)
Net cash provided by financing activities	**870**	116

	Dec. 31, 1997
Current assets	1,930
Total assets	2,620
Current liabilities	1,202
Total liabilities	1,697
Net assets (Philips' share 1997)	923

Acquisition ATL Ultrasound

ATL Ultrasound was acquired on October 2, 1998 for NLG 1,613 million in cash. ATL Ultrasound is a leading company in the high-performance ultrasound market. Included in the purchase price for ATL was goodwill paid for the amount of NLG 775 million, in-process R&D for the amount of NLG 401 million and NLG 115 million for patents and trademarks.

Goodwill and patents and trademarks are capitalized under intangible assets and amortized over 12 years and 8 years respectively.

In-process R&D represents the value assigned to research and development projects of ATL Ultrasound that were commenced but not yet completed at the date of acquisition and which, if unsuccessful, have no alternative future use in research and development activities or otherwise. In-process R&D was charged to expense at the date of acquisition.

2 Income from operations

Depreciation and amortization

Included in direct cost of sales is depreciation of property, plant and equipment and amortization of intangible assets.

	1998	1997	1996
Depreciation of property, plant and equipment	**3,412**	3,143	3,024
Amortization of goodwill	**119**	189	205
Amortization of patents and trademarks	**5**	–	–
Amortization of other intangible assets	**445**	–	14

In 1998, additional depreciation costs relating to write-downs of property, plant and equipment of NLG 148 million resulting from the recognition of asset impairment were reported in the separate line item restructuring charges (1997: NLG 145 million, 1996: NLG 144 million).

Amortization of goodwill relating to unconsolidated companies amounting to NLG 2 million (1997: NLG 18 million, 1996: NLG 14 million) was not included in costs of sales but was charged against results relating to unconsolidated companies.

Amortization of other intangible assets is NLG 445 million, representing amortized in-process R&D paid as part of acquisitions in 1998.

Research and development

Expenditures for research and development activities amounted to NLG 4,513 million, representing 6.7% of sales (1997: NLG 4,057 million, 6.2% of sales, 1996: NLG 4,050 million, 6.8% of sales). These expenditures are included in direct cost of sales.

Salaries and wages

	1998	1997	1996
Salaries and wages	**15,156**	15,173	14,778
Pension costs	**415**	622	647
Other social security and similar charges:			
Required by law	**2,162**	1,959	1,979
Voluntary	**357**	451	408
Total	**18,090**	18,205	17,812

Remuneration Board of Management and Supervisory Board

Board of Management

Remuneration and pension costs relating to the present members of the Board of Management amounted to NLG 25,808,000 (1997: NLG 17,328,000). The increase in these costs in 1998 is connected with the higher bonuses as a result of the profit level achieved in 1997 and the increase in the number of members of the Board of Management. The costs for former members of the Board of Management amounted to NLG 16,832,000 (1997: NLG 5,540,000). The increase in these costs is connected with the severance contracts of former members of the Board of Management concluded prior to 1998. In 1996, total remuneration and pension costs of present and former members of the Board of Management amounted to NLG 27,154,000.
In 1998, members of the Board of Management were granted 385,900 stock options (1997: 331,300 stock options). At year-end 1998 the present members of the Board of Management held a total of 799,800 stock options at a weighted average exercise price of NLG 112.93 (for information on stock options, see note 23 to the financial statements).

Supervisory Board

The remuneration of present members of the Supervisory Board amounted to NLG 831,000 (1997: NLG 724,000, 1996: NLG 836,000); former members received no remuneration. The remuneration for individual members is NLG 90,000 and for the Chairman NLG 165,000. Additionally, with effect from 1998, the membership of committees of the Supervisory Board is compensated. At year-end 1998 present members of the Supervisory Board own directly and/or beneficially 5,354 shares (1997: 5,836 shares) in the Company's capital and 28,100 stock options acquired before the membership of the Supervisory Board; no options were traded at the stock exchange.

Employees

The average number of employees during 1998 was 252,680 (1997: 255,664, 1996: 259,628). The number of employees by category is summarized as follows:

	1998			1997	1996
	beginning of year*	end of year	average **	average	average
Production	**145,247**	**131,551**	**146,249**	150,616	152,029
Research & development	**20,122**	**20,473**	**20,657**	21,238	23,065
Other	**64,781**	**63,436**	**64,494**	63,478	68,232
Permanent employees	**230,150**	**215,460**	**231,400**	235,332	243,326
Temporary employees	**21,750**	**18,226**	**21,280**	20,332	16,302
Total	**251,900**	**233,686**	**252,680**	255,664	259,628

* including changes in consolidations at January 1, 1998.
** (de)consolidation changes have not been taken into consideration in determining the average number of employees.

The number of employees at year-end 1998 went down by 18,214 as compared to the beginning of the year. This includes a decrease of 11,454 relating to consolidation changes.

Other business income

Other business income consists of amounts not directly related to the production and sale of products and services, including NLG 84 million relating to the net gain from the disposal of certain business interests which do not constitute separate lines of activities (1997: NLG 33 million, 1996: NLG 41 million).
Other business income also includes gains of NLG 163 million from the sale of fixed assets (1997: NLG 93 million, 1996: NLG 54 million) and various smaller items.

Restructuring charges

The provision for restructuring relates to the estimated costs of planned reorganizations that have been approved by the Board of Management and publicly announced, and which involve the realignment of certain parts of the industrial and commercial organization. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in total restructuring provisions. Of the provision for restructuring as of January 1, 1998 (NLG 718 million), an amount of NLG 355 million was utilized during 1998. An amount of NLG 57 million was released to income, principally relating to the Consumer Products (NLG 14 million), Semiconductors (NLG 12 million), Lighting (NLG 9 million) and Professional (NLG 17 million) sectors.
To the remaining balance of prior-years provisions (NLG 306 million), an amount of NLG 766 million was charged to income for new restructuring programs. This charge included lay-off costs of NLG 274 million for planned workforce reduction of approximately 4,000 persons and involved the Lighting (NLG 31 million), Components (NLG 24 million), Consumer Products (NLG 168 million), Professional (NLG 14 million) and Semiconductors (NLG 37 million) sectors. Asset write-downs included in this restructuring charge totaled NLG 424 million, mainly relating to the Consumer Products, Professional and Components sectors. The write-down amount was based on the discounted cash flow method. Other restructuring charges totaled NLG 68 million, principally for the Lighting and Consumer Products sectors.
In 1998, the net amount of additions and releases to income from operations came to NLG 726 million as compared to NLG 105 million in 1997.

Restructuring provision

		1998		1997
The changes in the provision for restructuring are as follows:				
Balance as of January 1		**718**		1,422
Changes:				
Utilization relating to prior-year provisions:				
- write-down of assets	**(43)**		(135)	
- personnel costs	**(230)**		(419)	
- other costs	**(76)**		(241)	
- consolidation changes/translation differences	**(6)**		(4)	
		(355)		(799)
Release of provisions against:				
- income from operations		**(40)**		(64)
- extraordinary income		**(17)**		–
Remaining prior-year provisions as of December 31		**306**		559
Additions charged against:				
- income from operations		**766**		169
- extraordinary income		**–**		13
Utilization relating to current-year provisions:				
- write-down of assets	**(403)**		(10)	
- personnel costs	**(29)**		(12)	
- other costs	**(53)**		(6)	
- other movements	**2**		6	
- translation differences	**(5)**		(1)	
		(488)		(23)
Balance as of December 31,		**584**		718

The remaining prior-year provisions at December 31, 1998 relate primarily to personnel lay-off costs. The Company expects to make cash expenditures of approximately NLG 0.5 billion in 1999 in connection with existing restructuring programs.

3 Financial income and expenses

	1998	1997	1996
Interest income	**169**	163	174
Interest expense	**(705)**	(911)	(941)
Total interest expense (net)	**(536)**	(748)	(767)
Other income from non-current financial assets	**87**	158	34
Value adjustments of non-current financial assets	**(7)**	(9)	(29)
Interest on provisions for pensions	**(131)**	(129)	(130)
Foreign exchange differences	**(87)**	27	11
Miscellaneous financing costs	**(12)**	(2)	(9)
Total	**(686)**	(703)	(890)

Interest paid decreased due to lower average debt, which declined from NLG 12.7 billion in 1997 to NLG 9.0 billion in 1998. Other income from non-current financial assets in 1998 mainly related to the gain on the sale of equity investments, principally in Flextronics (NLG 59 million). The 1997 gain mainly reflects the profit on the sale of the shares in Viacom and Fluke (NLG 128 million).
Foreign exchange differences primarily included increased hedging costs of hard currency loans to subsidiaries in emerging markets.

Beginning in 1999, interest on provisions for pensions will be included in income from operations.

4 Income taxes

Tax on income from continuing operations amounted to NLG 91 million in 1998 (1997: NLG 607 million, 1996: NLG 15 million benefit). In 1998, there was a tax expense of NLG 211 million on extraordinary items compared to a NLG 31 million benefit in 1997 and a NLG 159 million benefit in 1996.

The components of income before income taxes are as follows:

	1998	1997	1996
Netherlands	**728**	482	(148)
Foreign	**95**	2,592	187
Income before income taxes	**823**	3,074	39

The components of income tax expense are as follows:

	1998	1997	1996
Netherlands:			
Current taxes	**2**	(4)	23
Deferred taxes	**198**	162	(92)
	200	158	(69)
Foreign:			
Current taxes	**221**	395	279
Deferred taxes	**(330)**	54	(225)
	(109)	449	54
Income tax expense (benefit) from continuing operations	**91**	607	(15)

Philips' operations are subject to income taxes in various foreign jurisdictions with statutory income tax rates varying from 16.5% to 51% which cause a difference between the weighted average statutory income tax rate and the Netherlands' statutory income tax rate of 35%.

A reconciliation of the weighted average statutory income tax rate as a percentage of income before taxes and the effective income tax rate is as follows:

	1998	1997	1996
Weighted average statutory income tax rate	**30.7**	34.5	19.5
Tax effect of:			
Utilization of previously unrecognized loss carryforwards	**(93.0)**	(14.5)	(24.0)
New loss carryforwards not recognized	**57.4**	5.2	63.3
Changes in the valuation allowance for other deferred tax assets	**16.7**	(2.3)	(12.9)
Exempt income and non-deductible expenses	**18.1***	1.3	(7.4)
Tax incentives and other	**(18.8)**	(1.5)	(13.4)
Effect of sale of PolyGram	–	(3.0)	(65.2)
Effective tax rate	**11.1**	19.7	(40.1)

* of which 17.8 write-off of in-process R&D (ATL).

Deferred tax assets and liabilities

Deferred tax assets and deferred tax liabilities are as follows:

	1998		1997	
	assets	liabilities	assets	liabilities
Intangible fixed assets	**200**	**(20)**	210	(20)
Property, plant and equipment	**640**	**(710)**	680	(660)
Inventories	**200**	**(70)**	150	(50)
Receivables	**190**	**(60)**	210	(50)
Provisions:				
- for pensions	**280**	**(180)**	280	(160)
- restructuring	**140**	**(10)**	220	–
- guarantees	**30**	**–**	90	–
- other	**1,000**	**(190)**	720	(60)
Other assets	**140**	**(490)**	200	(700)
Other liabilities	**250**	**(310)**	470	(117)
Total deferred tax assets/liabilities	**3,070**	**(2,040)**	3,230	(1,817)
Net deferred tax position	**1,030**		1,413	
Tax loss carryforwards (including tax credit carryforwards)	**4,535**		4,449	
Valuation allowances	**(4,766)**		(5,022)	
Net deferred tax assets	**799**		840	

At December 31, 1998, operating loss carryforwards expire as follows:

Total	1999	2000	2001	2002	2003	2004/2008	later	unlimited
11,800	200	200	400	200	400	1,000	800	8,600

The Company also has tax credit carryforwards of NLG 267 million which are available to offset future tax, if any, and which expire as follows:

Total	1999	2000	2001	2002	2003	2004/2008	later	unlimited
267	3	2	3	5	15	39	7	193

Classification of the deferred tax assets and liabilities takes place at a fiscal entity level as follows:

	1998	1997
Deferred tax assets grouped under non-current receivables	**1,057**	1,088
Deferred tax liabilities grouped under provisions	**(258)**	(248)

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

	1998	1997
Income tax receivable grouped under non-current receivables	**80**	219
Income tax receivable grouped under current receivables	**298**	173
Income tax payable grouped under current liabilities	**(458)**	(565)

The amount of the unrecognized deferred income tax liability for temporary differences, totaling NLG 620 million (1997: NLG 530 million), related to unremitted earnings in foreign group companies and unconsolidated companies which are considered to be essentially permanent. Under current Dutch tax law, no additional taxes are payable. However, in certain jurisdictions, withholding taxes would be payable.

5 Results relating to unconsolidated companies

These results principally include the Company's share in the net income of Taiwan Semiconductor Manufacturing Co., ASM Lithography and the losses from the ongoing development costs of digitized street maps incurred by Navigation Technologies Corporation. Included in 1997 and 1996 is the share in the losses of Grundig AG through June 1997.

In 1998, an amount of NLG 16 million resulting from the sale of various companies was also included.
In 1997, the gain on the sale of the Company's stake in Bang & Olufsen was included.

In addition, a charge of NLG 2 million (1997: NLG 18 million, 1996: NLG 14 million), representing amortization of goodwill arising from the acquisition of unconsolidated companies, is included in the amount presented in the income statement, but not in equity in income presented in the following table.

Investments in, and loans to unconsolidated companies

The changes during 1998 are as follows:

	total	investments	loans
Balance as of January 1, 1998	2,524	2,469	55
Changes:			
Acquisitions/additions	471	291	180
Sales/redemptions	(536)	(497)	(39)
Equity in income	71	214	(143)
Dividend declared	(3)	(3)	–
Changes in consolidations	(222)	(219)	(3)
Other	(77)	(77)	–
Translation and exchange rate differences	(79)	(74)	(5)
Balance as of December 31, 1998	**2,149**	**2,104**	**45**

The investments in unconsolidated companies at December 31, 1998 includes NLG 25 million (1997: NLG 28 million) for companies accounted for under the cost method.

The total book value of unconsolidated companies is summarized as follows:

	1998	1997
Taiwan Semiconductor Manufacturing Co.	**1,375**	1,199
Philips Car Systems	–	443
ASM Lithography	**264**	231
Conventional Passive Components	**225**	–
Other	**285**	651
Total	**2,149**	2,524

To reflect the disposition of PolyGram as a discontinued operation, the net asset value of PolyGram as of December 31, 1997 has been recorded under unconsolidated companies for an amount of NLG 3,265 million. In December 1998, PolyGram was sold to Seagram (see note 1).

Under a preliminary agreement signed on September 27, 1998, Philips sold its Conventional Passive Components activities to an affiliate of Compass Partners International on January 14, 1999. Assets and liabilities were therefore no longer consolidated as of December 31, 1998. The net asset value of this business has been included under unconsolidated companies – investments – in the balance sheet. Sales and income over 1998 have been included in the consolidated Group accounts.
The gain on the diposal will be recognized in 1999.

The aggregate fair values of Philips' shareholding in TSMC and ASML, based on quoted market prices at December 31, 1998, were NLG 7.0 billion (1997: NLG 8.0 billion) and NLG 1.8 billion (1997: NLG 1.0 billion) respectively.

In December 1997, Philips and Mannesmann VDO signed a contract for the sale of Philips Car Systems to Mannesmann. Car Systems' net assets were deconsolidated at year-end 1997 and recognized in the balance sheet under Unconsolidated companies for an amount of NLG 443 million. Under the contract, Mannesmann VDO paid NLG 1,013 million in the first quarter of 1998. Additional payments in 1998 were made for an amount of NLG 69 million and subsequent payments of NLG 295 million will be received for amounts of NLG 26 million in 1999 and NLG 269 million in the year 2000. Reference is made to note 7.

6 Share of other group equity in group income

The share of other group equity in group income principally includes the share of third parties in the net income (loss) of consolidated companies. Mainly due to the loss-giving situation in PCC, the share of other group equity in 1998 amounted to a profit of NLG 374 million. In the years prior to 1998 the compensation paid on conversion certificates and similar securities was also included.

Other group equity

Minority interests in consolidated companies, totaling NLG 533 million (1997: NLG 1,232 million), are valued on the basis of their interest in the underlying net asset value.

7 Extraordinary items – net

	1998	1997	1996
Extraordinary gains	**1,298**	3,184	375
Extraordinary losses	**(77)**	(773)	(1,847)
Taxes	**(211)**	31	159
Total	**1,010**	2,442	(1,313)

Extraordinary items contributed NLG 1,010 million to net income in 1998. The sale of Philips Car Systems to Mannesmann VDO resulted in a net gain of NLG 836 million whereas the sale of the Optoelectronics unit to Uniphase Corporation and various other items amounted to NLG 174 million.

Accumulated translation differences relating to the disposed businesses reduced the gains on disposal by NLG 11 million (1997: NLG 12 million). Those translation differences were previously accounted for directly within stockholders' equity.
In extraordinary losses of 1998 are included costs of NLG 34 million resulting from the early repayment of debt.

The principal components of the NLG 3,184 million extraordinary gain reported in 1997 were the sale of a 5.4% shareholding in TSMC (NLG 1,979 million), the sale of 50% of UPC (NLG 491 million) and the sale of a portion of ASML (NLG 405 million). Other gains related to various divestitures.

The principal components of the 1997 extraordinary losses were Grundig (NLG 487 million) and costs resulting from the early repayment of debt (NLG 96 million). Other losses related to various divestitures.

In 1996, the extraordinary gain of NLG 375 million resulted from the flotation of part of Philips' shareholding in ASML.

The principal components of the 1996 extraordinary losses were the structural realignment of the Sound & Vision division, including the closure of substantial production facilities in Europe and the USA (NLG 800 million), and the first phase of the termination of the Grundig Unternehmensvertrag resulting in a charge of more than NLG 600 million. Other losses related to the Board's decision in 1996 to exit the media software business, the audio/video rental business, the divestiture of Data Communications and other Communication Systems operations.

8 Earnings per share

The earnings per share data have been calculated in accordance with SFAS No. 128 'Earnings per Share'. The weighted average number of common shares outstanding during the respective years are:

		1998		1997		1996
Weighted average number of shares		**360,056,076**		349,397,603		341,847,784
Basic EPS computation						
Income from continuing operations available to holders of common shares		**1,192**		2,712		278
Income from discontinued operations		**462**		579		445
Gain on sale of discontinued operations		**10,675**		–		–
Extraordinary items – net		**1,010**		2,442		(1,313)
Net income (loss) available to holders of common shares		**13,339**		5,733		(590)
Diluted EPS computation						
Income from continuing operations available to holders of common shares		**1,192**		2,712		278
Plus:						
Interest on assumed conversion of convertible debt, net of taxes		**2**		1		4
Income available to holders of common shares		**1,194**		2,713		282
Income from discontinued operations		**462**		579		445
Gain on sale of discontinued operations		**10,675**		–		–
Extraordinary items – net		**1,010**		2,442		(1,313)
Net income (loss) available to holders of common shares plus effect of assumed conversions		**13,341**		5,734		(586)
Weighted average number of shares		**360,056,076**		349,397,603		341,847,784
Plus, shares applicable to:						
- options	**2,010,923**		3,406,612		1,299,081	
- warrants	–		2,630,931		6,371,195	
- convertible debt	**952,124**		906,763		1,832,310	
Dilutive potential common shares		**2,963,047**		6,944,306		9,502,586
Adjusted weighted average number of shares		**363,019,123**		356,341,909		351,350,370

9 Cash and cash equivalents

Included in cash and cash equivalents are marketable securities of NLG 2 million (1997: NLG 22 million) with a market value of NLG 2 million (1997: NLG 35 million). Also included are time deposits with banks totaling NLG 268 million (1997: NLG 339 million) that are not freely available for withdrawal.

10 Receivables

Trade accounts receivable include installment accounts receivable of NLG 4 million (1997: NLG 9 million) and receivables from unconsolidated companies, primarily representing trade balances, for an amount of NLG 146 million (1997: NLG 205 million). Discounted drafts of NLG 65 million (1997: NLG 103 million) have been deducted.

Income tax receivable (current portion) for an amount of NLG 298 million (1997: NLG 173 million) is included under other receivables.

The changes in the allowances for doubtful accounts and notes are as follows:

	1998	1997	1996
Balance as of January 1,	**341**	252	478
Additions charged to income	**394**	268	135
Deductions from allowances *	**(133)**	(131)	(78)
Other movements **	**(191)**	(48)	(283)
Balance as of December 31,	**411**	341	252

* Write-offs for which allowances were provided.
** Including the effect of translation differences and consolidation changes.

11 Inventories

Inventories are summarized as follows:

	1998	1997
Finished products	**4,631**	4,846
Work in process, materials, parts and supplies	**4,788**	5,120
Total	**9,419**	9,966

Included in work in process, materials, parts and supplies is an amount of NLG 534 million (1997: NLG 364 million) of customer orders net of advance payments of NLG 242 million (1997: NLG 341 million).

12 Other non-current financial assets

The changes during 1998 are as follows:

	total	security investments	other loans and non-current receivables	restricted liquid assets
Balance as of January 1, 1998	674	279	256	139
Changes:				
Acquisitions/additions	3,596	3,447	130	19
Sales/redemptions	(232)	(83)	(149)	–
Value adjustments	(9)	(6)	(3)	–
Translation and exchange differences	(9)	(2)	(7)	–
Changes in consolidations	4	15	(11)	–
Other	77	77	–	–
Balance as of December 31, 1998	4,101	3,727	216	158
Accumulated total of write-downs included in the book value	19	8	11	–

Included in other non-current financial assets are securities that generate income unrelated to normal business operations. Other loans and non-current receivables are stated net of allowances for doubtful accounts of NLG 11 million (1997: NLG 2 million).
Included in security investments are shares valued at NLG 198 million (1997: NLG 207 million) that are not available for trade or redemption.

In connection with the sale of PolyGram to Seagram, Philips received 47,831,952 shares of Seagram whose fair value upon receipt on December 10, 1998 amounted to NLG 3,091 million and is recorded under security investments. Philips is restricted from selling this 12% shareholding until December 2000, a period of two years from the acquisition date. At year-end 1998, the market value of the Seagram shares that Philips holds amounted to NLG 3,399 million.

In connection with the sale of Optoelectronics B.V. to Uniphase Corporation, Philips received 3,259,646 common shares and 100,000 preference shares of Uniphase Corporation, making Philips a 8.5% stockholder in Uniphase. Philips is restricted from selling these shares for a period of one year from the acquisition date. At December 31, 1998, they are recorded under security investments at their fair value upon receipt of NLG 356 million. At year-end 1998, the market value of the Uniphase shares that Philips holds amounted to NLG 427 million.

13 Non-current receivables

Included in non-current receivables are receivables with a remaining term of more than one year and the non-current portion of income taxes receivable for an amount of NLG 80 million (1997: NLG 219 million). Prepaid expenses in 1998 include prepaid pension costs of NLG 2,005 million (1997: NLG 2,121 million) and deferred tax assets of NLG 1,057 million (1997: NLG 1,088 million).

14 Property, plant and equipment

Property, plant and equipment decreased from NLG 15,283 million at year-end 1997 to NLG 14,488 million at year-end 1998. The changes during 1998 were as follows:

	total	land and buildings	machinery and installations	other equipment	prepayments and construction in progress	no longer productively employed
Balance as of January 1, 1998:						
Cost	37,161	7,555	21,663	6,215	1,632	96
Accumulated depreciation	(21,878)	(3,637)	(13,508)	(4,655)	–	(78)
Book value	15,283	3,918	8,155	1,560	1,632	18
Changes in book value:						
Capital expenditures	3,600	403	2,399	799	(7)	6
Retirements and sales	(464)	(142)	(247)	(67)	(4)	(4)
Depreciation	(3,271)	(306)	(2,133)	(829)	(2)	(1)
Write-downs due to impairment	(289)	(18)	(237)	(34)	–	–
Translation differences	(402)	(85)	(226)	(41)	(49)	(1)
Changes in consolidations	31	114	(31)	(23)	(29)	–
Total changes	(795)	(34)	(475)	(195)	(91)	–
Balance as of December 31, 1998:						
Cost	36,741	7,609	21,492	6,011	1,541	88
Accumulated depreciation	(22,253)	(3,725)	(13,812)	(4,646)	–	(70)
Balance	**14,488**	**3,884**	**7,680**	**1,365**	**1,541**	**18**

Land is not depreciated.

The difference between replacement cost and historical cost of property, plant and equipment at year-end is estimated at approximately NLG 2.1 billion.

The expected service lives as of December 31, 1998 were as follows:

Buildings	from 14 to 50 years
Machinery and installations	from 5 to 10 years
Other equipment	from 3 to 5 years

15 Intangible assets

The changes during 1998 were as follows:

	total	goodwill	patents and trademarks	other intangibles
Balance as of January 1, 1998:				
Acquisition cost	886	886	–	–
Accumulated amortization	(418)	(418)	–	–
Book value	468	468	–	–
Changes in book value:				
Acquisitions	1,370	807	118	445
Amortization and write-downs	(569)	(119)	(5)	(445)
Translation differences	(48)	(46)	(2)	–
Total changes	753	642	111	–
Balance as of December 31, 1998:				
Acquisition cost	1,996	1,885	111	–
Accumulated amortization	(775)	(775)	–	–
Balance	**1,221**	**1,110**	**111**	**–**

Acquisitions under other intangibles represent the amount paid for in-process R&D as part of the acquisition of ATL Ultrasound and Active Impulse Systems, which amount was charged directly to the 1998 income statement.

As part of these acquisitions, additionally an amount of NLG 118 million was paid for patents and trademarks and capitalized as an intangible asset.

Furthermore, these acquisitions led to an increase in goodwill paid of NLG 783 million.

The remaining goodwill paid arose from various smaller acquisitions.

16 Accrued liabilities

Accrued liabilities are summarized as follows:

	1998	1997
Salaries and wages payable	**860**	1,100
Income tax payable	**458**	565
Accrued holiday rights	**454**	465
Accrued pension costs	**365**	–
Commissions, freight, interest and rent payable	**685**	673
Other transitory liabilities	**3,574**	3,275
Total	**6,396**	6,078

17 Provisions

Provisions are summarized as follows:

	1998	1997
Pensions:		
- defined benefit plans	**2,336**	2,074
- other pension obligations	**206**	557
- other postretirement benefits	**648**	626
Income taxes (see note 4)	**258**	248
Restructuring (see note 2)	**584**	718
Obligatory severance payments	**429**	440
Replacement and guarantees	**870**	818
Other provisions	**1,247**	1,683
Total	**6,578**	7,164
Long-term	**4,450**	5,098
Short-term	**2,128**	2,066

Pensions and postretirement benefits other than 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 plans. The benefits provided by these plans are based primarily on years of service and employees' compensation near retirement.

In addition to providing pension benefits, the Company provides other postretirement benefits, primarily retiree healthcare benefits, in certain countries.

Provided is a table with a summary of the changes in the pension benefit obligations and defined pension plan assets for 1998 and 1997, and a reconciliation of the funded status of these plans to the amount recognized in the consolidated balance sheets.

Also provided is a table with a summary of the changes in the unfunded accumulated postretirement benefit obligation for 1998 and 1997 and a reconciliation of the obligations to the amounts recognized in the consolidated balance sheets.

	1998	1997	1998	1997
		Pension benefits		Other benefits
Benefit obligation				
Benefit obligation at beginning of year	36,200	31,000	993	906
Service cost	802	633	25	20
Interest cost	2,057	2,074	73	70
Plan participants' contribution	72	81	–	–
Actuarial (gains) and losses	699	3,377	167	(22)
Plan amendments	7	95	–	–
Settlements	(284)	(8)	–	–
Curtailments	(6)	(16)	–	–
Changes in consolidations	717	(18)	–	–
Benefits paid	(1,759)	(1,587)	(75)	(64)
Exchange rate differences	(639)	1,017	(48)	88
Miscellaneous	757	(448)	8	(5)
Benefit obligation at end of year	**38,623**	36,200	**1,143**	993
Plan assets				
Fair value of plan assets at beginning of year	40,400	35,500	–	
Actual return on plan assets	4,434	5,096	–	
Employee contributions	72	61	–	
Plan participants' contribution	(88)	79	–	
Settlements	(232)	–	–	
Changes in consolidation	354	(16)	35	
Benefits paid	(1,626)	(1,453)	–	
Exchange rate differences	(709)	1,224	–	
Miscellaneous	637	(91)	–	
Fair value of plan assets at end of year	**43,242**	40,400	**35**	
Funded status	**4,619**	4,200	**(1,108)**	(993)
Unrecognized net transition (asset) obligation	**(821)**	(1,034)	**387**	431
Unrecognized prior service cost	**377**	464	**6**	–
Unrecognized net (gain) loss	**(4,871)**	(3,583)	**67**	(64)
Net balances	**(696)**	47	**(648)**	(626)
Classification of the net balances are as follows:				
- prepaid pension costs under non-current receivables	**2,005**	2,121		
- accrued pension costs under accrued liabilities	**(365)**	–		
- provisions for pensions under provisions	**(2,336)**	(2,074)		
	(696)	47		

The weighted average assumptions underlying the pension computation at December 31 were:

	1998	1997
Discount rate	**5.4%**	6.4%
Rate of compensation increase	**3.3%**	3.5%
Expected return on plan assets	**6.4%**	7.2%

Contributions are made by the Company, 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 legal and tax considerations as well as local customs. The Company funds certain defined benefit pension plans and other postretirement benefit plans as claims are incurred. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for defined benefit pension plans with accumulated benefit obligations in excess of plan assets were NLG 1,224 million, NLG 1,147 million and NLG 971 million, respectively as of December 31, 1998 (1997: NLG 855 million, NLG 831 million and NLG 735 million, respectively).

The components of net periodic pension cost related to major defined benefit plans, are as follows:

	1998	1997	1996
Service cost – benefits earned during the period	**802**	633	587
Interest cost on the projected benefit obligation	**2,057**	2,074	1,940
Expected return on plan assets	**(2,454)**	(2,196)	(2,070)
Net amortization of unrecognized net transition assets	**(207)**	(198)	(191)
Net actuarial gain recognized	**(124)**	(55)	(15)
Amortization of prior service cost	**59**	47	43
Settlement gain	**(57)**	–	–
Minimum pension liability loss	**102**	–	–
Net periodic pension cost	**178**	305	294

The Company also sponsors defined contribution and similar type plans for a significant number of salaried employees. The total cost with respect to these plans amounted to NLG 368 million in 1998 (1997: NLG 446 million, 1996: NLG 483 million).

The components of the net periodic cost of postretirement benefits other than pensions are:

	1998	1997	1996
Service cost – benefits earned during the period	**25**	20	19
Interest cost on accumulated postretirement benefit obligation	**73**	70	62
Amortization of unrecognized transition obligation	**30**	32	29
Net actuarial gain recognized	**–**	(3)	–
Net periodic cost	**128**	119	110

The accumulated postretirement benefit obligation was determined using a weighted average discount rate of 6.3% (1997: 7.1%) and a weighted average compensation increase, where applicable, of 4.25% (1997: 3.5%). For measurement purposes, the rate of increase in per capita health care costs is assumed to be on average 6.5% for 1999, reaching 5% by the year 2002. Health care cost trend assumptions have a significant effect on the amounts reported for other postretirement benefits. Increasing the assumed health care cost trend rate by 1 percentage point would increase the accumulated postretirement benefit obligation as of December 31, 1998 by approximately NLG 116 million and increase the net periodic postretirement benefit cost for 1998 by NLG 11 million. Conversely, decreasing the assumed health care cost trend by 1 percentage point would decrease the accumulated postretirement benefits as of December 31, 1998 by approximately NLG 99 million and decrease the net periodic postretirement benefit cost for 1998 by NLG 11 million.

Obligatory severance payments

The provision for obligatory severance payments covers commitments to pay to employees, or to relatives of deceased former employees, a lump sum in the case of retirement because of age, or in the case of death or dismissal of resignation of employees.

Replacement and guarantees

The provision for replacement and guarantees reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to products that have been sold.

Other provisions

Other provisions cover a wide range of risks and obligations. Included are provisions for expected losses on existing projects/orders for an amount of NLG 100 million (1997: NLG 120 million) and environmental provisions of NLG 356 million (1997: NLG 381 million).

The changes in the provisions for obligatory severance payments, replacement and guarantees and other provisions are as follows:

Balance as of January 1, 1998	2,941
Changes:	
- Additions	1,044
- Write-offs	(1,439)
Balance as of December 31, 1998	2,546

18 Other current liabilities

Other current liabilities are summarized as follows:

	1998	1997
Advances received from customers on orders not covered by work in process	**322**	341
Other taxes including social security premiums payable	**863**	983
Other short-term liabilities	**862**	141
Total	**2,047**	1,465

19 Short-term debt

Included in short-term debt are outstanding short-term bank borrowings totaling NLG 1,440 million (1997: NLG 1,508 million) and other short-term loans totaling NLG 325 million (1997: NLG 302 million) which include the current portion of long-term debt totaling NLG 315 million (1997: NLG 241 million). The weighted average interest rate on the bank borrowings was 6.5% (1997: 6.5%, 1996: 5.9%).

20 Long-term debt

	range of interest rates	average rate of interest	amount outstanding	due in 1999	due after 1999	due after 2003	average remaining term (in years)
Convertible debentures	1.2	1.2	167	–	167	–	4.0
Other debentures	5.6 – 8.8	7.3	4,866	50	4,816	3,128	7.0
Private financing	3.0 – 8.5	4.0	27	13	14	1	1.7
Bank borrowings	2.0 – 8.4	6.8	756	143	613	109	3.1
Other long-term debt	5.4 – 7.0	5.9	639	109	530	134	4.2
Total		**6.7**	**6,455**	**315**	**6,140**	**3,372**	
Corresponding data previous year		7.3	7,313	241	7,072	4,116	

The following amounts of long-term debt as of December 31, 1998 are due in the next five years:

1999	315
2000	685
2001	1,117
2002	530
2003	436
	3,083
Corresponding amount previous year	3,197

In 1998 and in 1997 certain debt was repaid prior to maturity resulting in a redemption premium which was charged against extraordinary items (see note 7). Approximately NLG 5.8 billion of the outstanding long-term debt is at fixed interest rates.

In the Netherlands, Philips issues personnel debentures with a 5-year right of conversion, all of which are convertible into common shares of Royal Philips Electronics. These personnel debentures are available to all permanent employees and are purchased by them with their own funds. They are redeemable on demand but in practice are considered to be a form of long-term financing. The personnel debentures become non-convertible debentures at the end of the conversion period. At such time, they will be reported as other long-term debt. The right of conversion currently exists for all debentures.
At December 31, 1998 an amount of NLG 167 million (1997: NLG 130 million) of personnel debentures was outstanding with an average conversion price of NLG 111.50 and an interest rate of 1.2%. The conversion price varies between NLG 51.60 and NLG 189.90, with various conversion periods ending between January 1, 1999 and December 31, 2003.

21 Commitments and contingent liabilities

The total of long-term lease commitments amounted to NLG 1,388 million in 1998 (1997: NLG 1,722 million). These leases expire at various dates during the next 40 years. The payments which fall due in connection with these obligations during the coming five years are:

1999	313
2000	269
2001	171
2002	130
2003	113

The total amount of contingent liabilities was NLG 57 million (1997: NLG 95 million). Guarantees given with regard to unconsolidated companies and third parties amounted to NLG 801 million (1997: NLG 1,386 million).

Royal Philips Electronics and certain of its group companies are involved as plaintiff or defendant in litigation relating to such matters as competition issues, commercial transactions, product liability, participations and environmental pollution. On the basis of information received to date, the Board of Management is of the opinion that this litigation should not materially affect Royal Philips Electronics' financial position and results of operations.

Although the Company has taken what it believes are reasonable, prudent measures to mitigate the risks through the implementation of the Philips Millennium program, the Company can give no assurances that such measures will be sufficient to prevent a materially adverse impact on its operations, liquidity and financial condition. The Company expects that the program's progression will result in reduced uncertainty relating to the Company's Year 2000 compliance and a reduced likelihood of interruptions to its operations.

22 Share premium and other reserves

Share premium

Share premium is fully exempt from Dutch taxes upon distribution to shareholders.

Warrants

Warrants for the purchase of common shares of Royal Philips Electronics were issued in 1992 to the remaining shareholders in Superclub Holding & Finance S.A. with an exercise price of NLG 34.00. All remaining warrants expired on June 30, 1998.

Option rights

Certain officers of the Company have been granted stock options on shares of Royal Philips Electronics at original exercise prices equal to market prices of the shares at the date of grant (see note 23).

Other reserves

In accordance with Dutch legislation, all other reserves are available for distribution to shareholders at December 31, 1998, without any restrictions.

The repurchase and sale of shares of Royal Philips Electronics held as treasury stock are directly accounted for in stockholders' equity under other reserves.

In order to reduce potential dilution effects, a total of 4,601,869 shares were acquired during 1998 at an average market price of NLG 154.43 per share and a total of 3,624,887 shares were sold at an average conversion price of NLG 74.97. There were 7,804,607 shares held by group companies as of December 31, 1998 (1997: 6,827,625 shares) acquired at an average price of NLG 147.58 per share.

23 Stock-based compensation

The Company has granted stock options on its common shares to certain officers and directors. The purpose of the stock option plans is to align the interest of management with the interest of shareholders by providing certain officers and other key employees with additional incentives to increase the Company's performance on a long-term basis, thereby increasing shareholder value. Under the Company's fixed option plans, options are granted at a price not less than the fair market value of the stock on the date of grant. Certain of these options were granted with a contractual life of five years and cliff vesting up to three years from the date of grant. The consideration for these options owed to the Company by the grantees is fixed at 7.5% of the exercise price. In 1998, the Company redesigned the stock option plans in line with guidelines from the fiscal authorities in the Netherlands. Also the Company no longer provides loans to employees to fund the exercise of options. The amount owed to the Company is lent to the grantee and is to be repaid upon exercise. Other options granted under the Company's fixed option plans have a ten-year contractual life and vest within three years from the date of grant.

Prior to 1998, options were granted under the Company's variable plans at a price equal to the market value of the stock on the date of grant, subject to the achievement of certain financial objectives during multi-year performance cycles. The options vest within three years after the end of the performance cycle and have a ten-year term. Exercise of all options is restricted by the Company's rules on insider trading.

USD-denominated stock options are granted to employees in the US only.

The pro forma net income, calculated as if the fair value of the options granted to officers and directors would have been considered as compensation costs is as follows:

	1998	1997	1996
Net income (loss), as reported	**13,339**	5,733	(590)
Pro forma net income (loss)	**13,298**	5,724	(621)
Basic earnings per share as reported	**37.05**	16.41	(1.73)
Pro forma basic earnings per share	**36.93**	16.38	(1.82)

This pro forma net income may not be representative of that to be expected in future years.

The fair value of the Company's 1998, 1997 and 1996 option grants was estimated using a Black-Sholes option pricing model and the following assumptions:

Fixed option plans	**1998**	**1998**	1997	1996
	(USD denominated)	(NLG denominated)		
Risk-free interest rate	**5.30%**	**4.16%**	3.87%	4.80%
Expected dividend yield	**1.40%**	**1.40%**	1.50%	2.00%
Expected option life	**5 yrs.**	**3 yrs.**	3 yrs.	3 yrs.
Expected stock price volatility	**34%**	**36%**	29%	25%

Variable option plans	(USD denominated)	
Risk-free interest rate	6.30%	5.75%
Expected dividend yield	1.50%	2.00%
Expected option life	4 yrs.	5 yrs.
Expected stock price volatility	30%	29%

These assumptions were used for these calculations only and do not necessarily represent an indication of management's expectations of future development.

The following table summarizes information about the stock options outstanding at December 31, 1998:

Fixed option plans

	options outstanding			options exercisable	
	number outstanding at Dec. 31, 1998	exercise price per share (price in NLG)	weighted average remaining contractual life (years)	number exercisable at Dec. 31, 1998	weighted average price per share (price in NLG)
1994	130,100	50.00	0.2	130,100	50.00
1995	316,800	55.60	1.2	316,800	55.60
1996	719,000	58.30-66.40	2.2	719,000	66.13
1997	1,361,400	81.00-171.30	3.3	–	
1998	1,316,900	102.00-185.30	4.2	–	
		(price in USD)			
1998	621,150	51.75-94.37	9.3	–	
	4,465,350			1,165,900	

Variable plans

		(price in USD)			(price in USD)
1991-1992	42,454	11.81-21.38	2.0	42,254	12.82
1993-1994	182,250	11.00-27.56	4.0	182,250	11.66
1995-1997	976,480	30.00-56.81	6.0	236,866	31.41
	1,201,184			461,370	

A summary of the status of the Company's stock option plans as of December 31, 1998, 1997 and 1996 and changes during the years then ended is presented below:

Fixed option plans

	1998		1997		1996	
	shares	weighted average exercise price in NLG	shares	weighted average exercise price in NLG	shares	weighted average exercise price in NLG
Outstanding at the beginning of the year	**5,290,500**	**68.77**	6,805,600	54.95	6,889,800	43.35
Granted	**1,316,900**	**143.64**	1,376,400	96.98	2,031,400	66.21
Exercised	**(2,763,200)**	**57.70**	(2,891,500)	49.70	(2,115,600)	27.99
Forfeited	–		–		–	
Outstanding at the end of the year	**3,844,200**	**102.37**	5,290,500	68.77	6,805,600	54.95
Weighted average fair value of options granted during the year in NLG	**34.32**		18.57		10.23	

		price in USD
Outstanding at the beginning of the year	–	
Granted	**626,900**	**71.61**
Exercised	–	
Forfeited	**(5,750)**	**73.34**
Outstanding at the end of the year	**621,150**	**69.34**
Weighted average fair value of options granted during the year in USD	**24.50**	

Variable plans

	shares	weighted average exercise price in USD	shares	weighted average exercise price in USD	shares	weighted average exercise price in USD
Outstanding at the beginning of the year	**1,819,038**	**26.32**	2,367,051	23.32	2,421,897	21.61
Granted	–		32,440	40.26	154,022	36.15
Exercised	**(399,860)**	**18.94**	(532,351)	12.74	(197,207)	12.97
Forfeited	**(217,994)**	**31.65**	(48,102)	38.19	(11,661)	12.92
Outstanding at the end of the year	**1,201,184**	**27.80**	1,819,038	26.32	2,367,051	23.32
Weighted average fair value of options granted during the year in USD	–		11.87		10.83	

Concentrations of credit risk

Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. The Company does not have significant exposure to any individual customer or counterparty.

To reduce exposure to credit risk, the Company performs ongoing credit evaluations of the financial condition of its customers but generally does not require collateral. The Company invests available cash and cash equivalents with various banks.

The Company is exposed to credit-related losses in the event of non-performance by counterparties with respect to derivative financial instruments. However, given their high credit ratings, management does not expect any counterparties to fail to meet their obligations.

Fair value of financial assets and liabilities

The estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methods. The estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market exchange or the value that ultimately will be realized by the Company upon maturity or disposition. Additionally, because of the variety of valuation techniques permitted under SFAS No. 107, comparability of fair values between entities may not be meaningful. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts.

	December 31, 1998		December 31, 1997	
	carrying amount	estimated fair value	carrying amount	estimated fair value
Assets:				
Cash and cash equivalents	**14,441**	**14,441**	3,079	3,092
Accounts receivable – current	**11,312**	**11,312**	11,699	11,699
Other financial assets	**4,101**	**4,494**	674	674
Accounts receivable – non-current	**1,084**	**1,084**	542	542
Liabilities:				
Accounts payable	**(6,496)**	**(6,496)**	(6,400)	(6,400)
Debt	**(7,905)**	**(8,380)**	(8,882)	(9,282)
Currency exchange agreements (net)	**(29)**	**(29)**	(8)	(8)

The following methods and assumptions were used to estimate the fair value of financial instruments:

Cash, accounts receivable and accounts payable

The carrying amounts approximate fair value because of the short maturity of those instruments.

Cash equivalents

The fair value is based on the estimated aggregate market value.

Other financial assets

For other financial assets, fair value is based upon the estimated market prices or, because they bear interest, at current market rates. The fair value of equity investments is based on quoted market prices.

Debt and conversion certificates

The fair value is estimated on the basis of the quoted market prices for certain issues, or on the basis of discounted cash flow analyses based upon Philips' incremental borrowing rates for similar types of borrowing arrangements with comparable terms and maturities.

Currency exchange agreements

The fair value is the amount that the Company would receive or pay to terminate the exchange agreements, considering currency exchange rates and remaining maturities.

25 Application of Generally Accepted Accounting Principles in the United States of America

The accounting policies followed in the preparation of the consolidated financial statements differ in some respects from those generally accepted in the United States of America.

To determine net income and stockholders' equity in accordance with generally accepted accounting principles in the United States of America (US GAAP), Philips has applied the following accounting principles:

- Under Dutch GAAP, goodwill arising from acquisitions prior to 1992 was charged directly to stockholders' equity. According to US GAAP, goodwill arising from acquisitions, including those prior to 1992, is capitalized and amortized over its useful life up to a maximum period of 40 years. As a result of the sale of PolyGram, goodwill has been fully amortized and charged to the gain on disposal in 1998 income under US GAAP.
- Philips reported a charge to income from operations of NLG 726 million for restructurings in its 1998 financial statements. A portion of this restructuring, NLG 89 million (NLG 51 million net of taxes), was not communicated to employees until early 1999 and, accordingly, will be recorded under US GAAP as a charge in 1999.

  An identical restructuring charge for Grundig was recorded in 1995 under Dutch GAAP for an amount of NLG 262 million, which under US GAAP was reflected in the 1996 accounts.

  Until 1997 the Company had an obligation under certain put options given to other shareholders in Grundig. For the purposes of US GAAP this liability was recorded in 1995, whereas under Dutch GAAP it was accrued in 1996. Philips settled this obligation.
- In 1998, Philips reported a charge to net income of NLG 74 million (1997: NLG 139 million) relating to a higher accumulated benefit obligation compared to the market value of the plan assets or the existing level of the pension provision in two of the Company's pension plans. For US GAAP purposes, this amount is capitalized as an intangible asset for this additional minimum liability, or directly charged to comprehensive income.
- In July 1995, Philips contributed its net assets of cable networks, with a book value of approximately NLG 200 million, to UPC, a newly established joint venture in which Philips had acquired a 50% interest. Under Dutch GAAP, this transfer resulted in a gain of NLG 127 million relating to the partial disposal of its interest in these assets to the other joint venture party (UIH). For US GAAP purposes, this gain was not considered realized because the consideration received by Philips principally consisted of equity and notes issued by UPC and equity in UIH, instead of cash. In 1997, Philips sold its 50% interest in this joint venture, the gain of NLG 127 million on this transaction was recognized under US GAAP in 1997.
- Under Dutch GAAP's historical cost convention, Philips generally considers the functional currency of entities in a highly inflationary economy to be the US dollar. Under US GAAP, the functional currency would be the reporting currency. The difference between the use of the US dollar as the functional currency instead of the reporting currency is not material.

- Under Dutch GAAP, securities available for sale are valued at the lower of cost or net realizable value. Under US GAAP they are valued at market price, unless such shares are restricted by contract for a period of one year or more. Under US GAAP, unrealized holding gains or losses will be credited or charged to stockholders' equity.
- Under US GAAP, it is not appropriate to record a liability for dividends/distribution to shareholders subject to approval of the Annual General Meeting of Shareholders.
- Under Dutch GAAP, majority-owned entities are consolidated. Under US GAAP, consolidation of majority-owned entities is not permitted if minority interest holders have the right to participate in operating decisions of the entity. Although Philips owned 60% of Philips Consumer Communications under US GAAP the venture with Lucent Technologies could not be consolidated but should have been accounted for under the equity method. For the effect of the consolidation, reference is made to note 1.
- Under Dutch GAAP, catalogues of recorded music, music publishing rights, film rights and theatrical rights belonging to PolyGram, which company was sold in 1998, were written down if and to the extent that the present value of the expected income generated by the acquired catalogues falls below their book value. Under US GAAP they were initially amortized over a maximum period of 30 years. As a result of the sale of PolyGram, the cumulative amortization has been credited to the gain on disposal in 1998 income under US GAAP.
- According to US GAAP, divestments which cannot be regarded as discontinued segments of business must be included in income from continuing operations. Under Dutch GAAP, certain material transactions such as disposals of lines of activities, including closures of substantial production facilities, have been accounted for as extraordinary items, which under US GAAP would be recorded in income from operations.
- Under Dutch GAAP, funding of NavTech activities is accounted for as results relating to unconsolidated companies (1998: NLG 134 million, 1997: NLG 210 million, 1996: NLG 66 million) whereas under US GAAP these amounts have to be included in income from operations as research and development costs.

	1998	1997	1996
Income from continuing operations as per the consolidated statements of income	**1,192**	2,712	278
Reclassification extraordinary items under Dutch GAAP	**1,044**	2,538	(1,313)
Adjustments to US GAAP:			
- amortization of goodwill from acquisitions prior to 1992	**–**	(21)	(50)
- reversal of provisions for restructuring (net)	**51**	–	(262)
- liabilities relating to Grundig put options	**–**	–	127
- additional minimum liabilities under SFAS No. 87 (net)	**74**	139	–
- reversal of gain on UPC transaction	**–**	127	–
- pension cost relating to the acquisition of PENAC	**–**	(16)	(13)
- other items	**(15)**	(15)	(21)
Income from continuing operations in accordance with US GAAP	**2,346**	5,464	(1,254)
Income from discontinued operations	**462**	513	388
Gain on disposal of discontinued operations	**10,316**	–	–
Extraordinary items	**(34)**	(96)	–
Net income in accordance with US GAAP	**13,090**	5,881	(866)
Basic earnings per common share in NLG:			
- income (loss) from continuing operations	**6.52**	15.64	(3.67)
- income from discontinued operations	**1.28**	1.46	1.14
- gain on disposal of discontinued operations	**28.65**	–	–
- extraordinary items	**(0.09)**	(0.27)	–
- net income (loss)	**36.36**	16.83	(2.53)
Diluted earnings per common share in NLG:			
- income (loss) from continuing operations	**6.46**	15.34	(3.67)
- income from discontinued operations	**1.27**	1.44	1.14
- gain on disposal of discontinued operations	**28.42**	–	–
- extraordinary items	**(0.09)**	(0.27)	–
- net income (loss)	**36.06**	16.51	(2.53)

In addition to the reconciliation of net income in accordance with Dutch GAAP versus US GAAP, the disclosure of 'Comprehensive Income' is required to be reported under US GAAP, commencing in 1998.

Comprehensive income is defined as all changes in equity of a business enterprise during a period, except investments by, and distributions to equity owners. Accordingly, comprehensive income consists of net income and other items that are reflected in stockholders' equity on the balance sheet and have been excluded from the income statement. Such items of other comprehensive income include foreign currency translation adjustments, gains and losses on currency transactions qualifying for hedge treatment, certain pension liability-related losses not yet recorded as pension costs and unrealized holding gains and losses on securities available for sale.

Comprehensive income statement

	1998	1997	1996
Net income in accordance with US GAAP	**13,090**	5,881	(866)
Other comprehensive income (net of taxes):			
- translation differences	**(335)**	646	1,076
less: reclassification for translation losses included in net income	**(93)**	(85)	(124)
- deferred foreign exchange results	**34**	–	–
- minimum pension liability charge	**(108)**	–	–
- holding gain on securities available for sale	**71**	(140)	(101)
Comprehensive income in accordance with US GAAP	**12,659**	6,302	(15)

Reconciliation of stockholders' equity according to Dutch GAAP versus US GAAP

	1998	1997
Stockholders' equity as per consolidated balance sheets	**31,292**	19,457
Equity adjustments that affect net income:		
Intangible assets – goodwill (Polygram)	**–**	758
Intangible assets – catalogues of recorded music	**–**	(399)
Reversal of provisions for restructuring	**51**	–
Intangible assets relating to additional liabilities under SFAS No. 87	**105**	139
Adjustment highly inflationary countries, mainly to property, plant and equipment	**49**	64
Equity adjustments not affecting net income under US GAAP:		
Holding gain on securities available for sale	**71**	–
Dividend payable subject to approval of the Annual General Meeting of Shareholders	**794**	716
Stockholders' equity in accordance with US GAAP	**32,362**	20,735
Translation differences as included in stockholders' equity	**(3,108)**	(2,773)

26 Information relating to product sectors and geographic areas

Segment reporting

In 1998, the Company changed its product sector reporting to comply with the new requirements of Statement of Financial Accounting Standard No. 131, issued by the Financial Accounting Standards Board of the USA.

As a consequence, the Philips activities are now grouped together into seven product sectors and reported separately: *Lighting, Consumer Products, Components, Semiconductors, Professional, Origin, Miscellaneous.*

Lighting

Philips is a leader in the world lighting market. A wide variety of applications are served by a full range of incandescent and halogen lamps, automotive lamps, high-intensity gas-discharge and special lamps, QL induction lamps, fixtures, ballasts, lighting electronics and batteries.

Consumer Products

This sector comprises the divisions Consumer Electronics and Domestic Appliances and Personal Care. Moreover, the revenues from license agreements are included in this sector.

Consumer Electronics

This division markets a wide range of consumer products in the following areas: video products (TV, VCR, tuners, remote controls), audio (audio systems, portable products, speaker systems, CD-Recordable), PC peripherals (monitors, PC add-ons), personal communication (mobile phones, corded/cordless phones) and new digital products (DVD, Flat TV, Internet TV, mobile computing products such as Velo, Nino).

Domestic Appliances and Personal Care

This division markets a wide range of products in the following areas: home comfort (vacuum cleaners, steam irons, etc.), kitchen appliances (food processors, mixers, coffee makers, etc.) and personal care (shavers, depilators, hair dryers, etc.).

Components

Philips Components is a major supplier of components and subsystems, with a wide range of products, such as picture tubes (both for TV and Monitors), liquid crystal displays (LCDs), passive components, magnetic products and modules for optical storage.

Semiconductors

Philips Semiconductors is a leading supplier of integrated circuits (ICs) and discrete semiconductors for application in consumer, telecommunication, multimedia and automotive electronics.

Professional

This sector comprises the divisions Medical Systems and Business Electronics.

Medical Systems

Philips is among the top three makers of systems for diagnostic imaging, based on x-ray, magnetic resonance and ultrasound technologies. It also provides consultancy services, information management, training and technical services to its customers in the healthcare sector.

Business Electronics

This division focuses on the business-to-business sector. Main product areas are digital video-communication systems, broadband network equipment, business communication systems, communication and security systems, and fax equipment. The division is a major supplier of electronic manufacturing equipment to the semiconductor industry. It also deals with infrastructural and industrial projects.

Origin

Origin is a global IT service company delivering systems and a full range of services that facilitate total business solutions for clients. It is represented in more than 30 countries. Philips holds a majority interest of 88% in Origin B.V.

Miscellaneous

This sector comprises not only various ancillary businesses including Philips Plastics and Metalware Factories and Philips Machinefabrieken but also various (remaining) activities that have been sold, discontinued, phased out or deconsolidated in earlier years, such as Grundig, Philips Media, Philips Car Systems, Super Club and ASM Lithography.

Unallocated

The sector Unallocated includes general and administrative expenses in the corporate center and the national organizations. The costs of basic research and patents are included in the Miscellaneous sector.

All years presented have been restated for comparability reasons and reflect the performance of continuing operations, i.e. excluding PolyGram, which also ceased to be a separate product sector. For a description of various product divisions included in the product sectors, reference is made to the relevant section in this report.

Sales to third parties by product sector and by geographic area are shown in the following tables. Sales to third parties by geographic area represent the total proceeds from products and services supplied to third parties in the geographic area concerned. The sales growth rates are also presented on a comparable basis, adjusted for the effects of changes in consolidations and exchange rate movements.

The sales volumes of the various business activities and the associated income from operations by product sector and by geographic area are set forth in the following tables. Segment revenues include sales to third parties ('sales') as well as sales of products and services between the product sectors ('intersegment sales').
Included in segment revenues by geographic area is the total revenue from worldwide sales to third parties by companies located within that geographic area, as well as the total value of sales to consolidated companies in other geographic areas ('interregional sales').
The transfer prices charged for all intersegment (including interregional) sales are based on the arm's length principle as set forth in internationally accepted transfer pricing policies and guidelines.

Grundig was deconsolidated as of December 31, 1996. However its results of operations were consolidated for the year then ended. Group sales for 1996 included NLG 3.7 billion relating to Grundig.
Car Systems was deconsolidated as of December 31, 1997. However its results of operations were consolidated for the year then ended. Group sales for 1997 and 1996 included NLG 1.7 billion and NLG 1.5 billion respectively relating to Car Systems.
Both divested activities have now been included in the Miscellaneous sector.

The Consumer Products sector includes 3 months of operations of the PCC/Lucent joint venture in 1997 and 9 months in the current reporting year 1998.
For further details reference is made to note 1.

Sales and sales growth and number of employees by product sector

1998

	sales (to third parties)	% growth nominal	% growth comparable	number of employees
Lighting	9,813	(2)	1	48,997
Consumer Products	27,485	9	7	51,643
Components	8,404	4	5	42,613
Semiconductors	7,079	2	5	26,583
Professional	9,961	5	7	24,646
Origin	2,333	25	24	16,948
Miscellaneous	2,047	(45)	6	15,150
Unallocated				7,106
Total	**67,122**	**3**	**6**	**233,686**

1997

	sales (to third parties)	% growth nominal	% growth comparable	number of employees
Lighting	10,024	13	5	51,727
Consumer Products	25,265	19	7	66,046
Components	8,075	27	5	46,131
Semiconductors	6,928	24	14	26,916
Professional	9,478	12	11	21,208
Origin	1,865	30	21	15,464
Miscellaneous	3,723	(52)	6	17,109
Unallocated				7,667
Total	65,358	9	8	252,268

1996

	sales (to third parties)	% growth nominal	% growth comparable	number of employees
Lighting	8,869	6	3	49,879
Consumer Products	21,223	11	8	61,113
Components	6,336	17	13	41,995
Semiconductors	5,589	6	1	25,833
Professional	8,458	12	8	24,271
Origin	1,436	407	70	13,341
Miscellaneous	7,796	(19)	2	25,607
Unallocated				7,920
Total	59,707	7	6	249,959

Sales and sales growth and number of employees by main countries.

	sales (to third parties)	% growth nominal	% growth comparable	number of employees
1998				
Netherlands	3,642	14	22	44,476
United States	15,786	11	6	25,178
Germany	6,119	(2)	4	14,181
France	4,611	(4)	4	12,228
United Kingdom	4,256	9	12	8,801
Other countries	32,708	(1)	5	128,822
Total	**67,122**	**3**	**6**	**233,686**
1997				
Netherlands	3,191	(1)	4	46,032
United States	14,159	26	8	30,407
Germany	6,258	(22)	1	15,448
France	4,796	(4)	8	14,779
United Kingdom	3,911	11	2	9,963
Other countries	33,043	15	11	135,639
Total	65,358	9	8	252,268
1996				
Netherlands	3,211	18	5	45,836
United States	11,206	2	2	27,519
Germany	8,039	–	–	17,101
France	4,980	–	4	16,663
United Kingdom	3,511	10	9	10,807
Other countries	28,760	12	11	132,033
Total	59,707	7	6	249,959

	segment revenues	income (loss) from operations	as % of segment revenues	income (loss) from operations*
				1998
Lighting	9,925	1,311	13.2	1,366
Consumer Products	28,120	(613)	(2.2)	(118)
Components	11,590	98	0.8	200
Semiconductors	8,732	1,687	19.3	1,720
Professional	10,245	(122)	(1.2)	(72)
Origin	3,645	130	3.6	130
Miscellaneous	2,507	(102)	(4.1)	(104)
Unallocated		(880)		(887)
Total	**74,764**	**1,509**		**2,235**
Intersegment sales	**(7,642)**			
Sales	**67,122**			
Income from operations as a % of sales		**2.2**		**3.3**
				1997
Lighting	10,141	1,151	11.3	1,239
Consumer Products	26,871	738	2.7	754
Components	11,237	562	5.0	560
Semiconductors	8,359	1,700	20.3	1,731
Professional	9,816	456	4.6	452
Origin	2,918	–	–	–
Miscellaneous	4,632	30	0.6	(3)
Unallocated		(860)		(851)
Total	73,974	3,777		3,882
Intersegment sales	(8,616)			
Sales	65,358			
Income from operations as a % of sales		5.8		5.9
				1996
Lighting	8,980	702	7.8	795
Consumer Products	22,991	421	1.8	463
Components	9,582	696	7.3	787
Semiconductors	6,753	800	11.8	800
Professional	8,698	40	0.5	55
Origin	2,425	(160)	(6.6)	(64)
Miscellaneous	9,068	(722)	(8.0)	(589)
Unallocated		(848)		(753)
Total	68,497	929		1,494
Intersegment sales	(8,790)			
Sales	59,707			
Income from operations as a % of sales		1.6		2.5

* Excluding restructuring

1998	segment revenues	income (loss) from operations	as % of segment revenues	income (loss) from operations*
Netherlands	27,015	982	3.6	1,018
Europe excl. Netherlands	36,206	1,405	3.9	1,534
USA and Canada	18,891	(1,042)	(5.5)	(639)
Latin America	4,436	(451)	(10.2)	(443)
Africa	278	(2)	(0.7)	(2)
Asia	22,065	632	2.9	782
Australia and New Zealand	923	(15)	(1.6)	(15)
Total	**109,814**	**1,509**		**2,235**
Interregional sales	**(42,692)**			
Sales	**67,122**			
Income from operations as a % of sales		**2.2**		**3.3**

1997	segment revenues	income (loss) from operations	as % of segment revenues	income (loss) from operations*
Netherlands	23,424	837	3.6	878
Europe excl. Netherlands	34,887	1,515	4.3	1,574
USA and Canada	16,846	23	0.1	2
Latin America	4,637	(122)	(2.6)	(122)
Africa	250	7	2.8	7
Asia	23,807	1,548	6.5	1,574
Australia and New Zealand	1,316	(31)	(2.4)	(31)
Total	105,167	3,777		3,882
Interregional sales	(39,809)			
Sales	65,358			
Income from operations as a % of sales		5.8		5.9

1996	segment revenues	income (loss) from operations	as % of segment revenues	income (loss) from operations*
Netherlands	20,259	220	1.1	447
Europe excl. Netherlands	34,323	(442)	(1.3)	(268)
USA and Canada	12,577	(206)	(1.6)	(54)
Latin America	4,329	241	5.6	253
Africa	275	6	2.2	6
Asia	18,484	1,075	5.8	1,075
Australia and New Zealand	1,194	35	2.9	35
Total	91,441	929		1,494
Interregional sales	(31,734)			
Sales	59,707			
Income from operations as a % of sales		1.6		2.5

* Excluding restructuring

1998	total assets	net operating capital	(in)tangible fixed assets	capital expenditures	depreciation
Lighting	5,746	3,887	2,631	420	382
Consumer Products	9,586	3,721	1,811	838	733
Components	6,858	4,563	4,111	659	788
Semiconductors	6,845	4,199	3,492	962	1,002
Professional	6,193	3,034	1,663	194	170
Origin	1,260	324	405	152	140
Miscellaneous	2,251	1,121	889	205	233
Unallocated	23,302	467	707	170	112
Total	**62,041**	**21,316**	**15,709**	**3,600**	**3,560**

1997					
Lighting	6,001	4,008	2,732	476	412
Consumer Products	11,205	5,364	2,207	629	742
Components	6,932	4,884	4,308	881	612
Semiconductors	6,911	4,342	3,627	798	812
Professional	4,823	1,942	865	272	217
Origin	1,085	277	445	138	129
Miscellaneous	2,419	594	832	282	235
Unallocated	8,753	751	735	109	129
Total	48,129	22,162	15,751	3,585	3,288
Discontinued operations	3,265				
Total	51,394				

1996					
Lighting	5,946	4,118	2,715	657	345
Consumer Products	9,614	4,983	2,029	779	718
Components	5,791	4,179	3,640	1,051	632
Semiconductors	6,771	4,437	3,756	1,284	639
Professional	4,975	2,039	932	277	186
Origin	948	209	366	170	143
Miscellaneous	4,081	1,015	1,204	446	407
Unallocated	7,512	441	654	151	98
Total	45,638	21,421	15,296	4,815	3,168
Discontinued operations	2,640				
Total	48,278				

1998	total assets	net operating capital	(in)tangible fixed assets	capital expenditures	depreciation
Netherlands	26,143	6,123	3,598	891	755
United States	7,752	3,388	2,572	341	417
Germany	3,384	1,475	1,539	316	552
France	2,491	348	903	167	285
United Kingdom	1,999	1,111	656	133	141
Other countries	20,272	8,871	6,441	1,752	1,410
Total	**62,041**	**21,316**	**15,709**	**3,600**	**3,560**

1997					
Netherlands	10,826	6,518	3,720	583	765
United States	8,067	3,003	2,265	304	398
Germany	4,040	1,508	1,546	344	356
France	3,019	884	1,121	309	325
United Kingdom	2,000	1,148	747	161	125
Other countries	20,177	9,101	6,352	1,884	1,319
Total	48,129	22,162	15,751	3,585	3,288
Discontinued operations	3,265				
Total	51,394				

1996					
Netherlands	11,746	6,611	3,948	1,273	790
United States	5,709	2,447	1,879	531	412
Germany	4,274	1,065	1,687	547	510
France	3,260	1,128	1,301	409	281
United Kingdom	2,017	1,013	716	232	95
Other countries	18,632	9,157	5,765	1,823	1,080
Total	45,638	21,421	15,296	4,815	3,168
Discontinued operations	2,640				
Total	48,278				

Balance sheets and statements of income of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics')

in millions of Dutch guilders – including a liability for the proposed dividend

Balance sheets as of December 31

			1998		1997
	Assets				
	Non-current assets:				
A	Intangible fixed assets	**175**		245	
B	Tangible fixed assets	**2**		2	
C	Investments in affiliated companies	**27,035**		27,922	
D	Other non-current financial assets	**3,475**		33	
			30,687		28,202
	Current assets:				
E	Receivables	**1,569**		1,536	
	Cash and cash equivalents	**11,378**		1,055	
			12,947		2,591
	Total		**43,634**		30,793
	Liabilities and stockholders' equity				
F	Stockholders' equity:				
	Issued, paid-up capital		**3,685**		3,648
	Share premium account		**4,019**		3,943
	Reserves		**23,588**		11,866
			31,292		19,457
	Provisions:				
G	Long-term		**233**		215
G	Short-term		**2**		5
H	Long-term debt		**5,211**		5,694
	Current liabilities:				
I	Short-term debt		**5,717**		4,323
J	Other liabilities		**385**		383
	Dividend payable		**794**		716
	Total		**43,634**		30,793

Statements of income

	Income after taxes from affiliated companies	**1,993**	5,632
	Income from discontinued operations	**462**	–
	Gain on disposal of discontinued operations	**10,675**	–
	Other income after taxes	**209**	101
K	**Net income**	**13,339**	5,733

all amounts in millions of Dutch guilders unless otherwise stated

For the policies with regard to valuation and income determination, see pages 72-78 of the financial statements, which form part of these notes.

A Intangible fixed assets

Balance as of January 1, 1998:	
Acquisition cost	318
Accumulated amortization	(73)
Book value	245
Changes in book value:	
Acquisitions	4
Amortization and write-downs	(74)
Total changes	(70)
Balance as of December 31, 1998:	
Acquisition cost	271
Accumulated amortization	(96)
Balance	**175**

The acquisitions mainly relate to goodwill arising from the purchase of the minority interest in Philips Consumer Electronics Industries Poland Sp. z.o.o.

B Tangible fixed assets

Balance as of January 1, 1998:	
Cost	2
Accumulated depreciation	–
Book value	2
Changes in book value:	
Capital expenditures	1
Retirements and sales	(1)
Depreciation and write-downs	–
Total changes	–
Balance as of December 31, 1998:	
Cost	3
Accumulated depreciation	(1)
Balance	**2**

Tangible fixed assets consist of fixed assets other than land and buildings.

C Investments in affiliated companies

The investments in affiliated companies are included in the balance sheet based on their net asset values in conformity with the aforementioned accounting principles of the consolidated financial statements or purchase price.

	total	investments	loans
Balance as of January 1, 1998	27,922	21,069	6,853
Changes:			
Acquisitions/additions	7,084	2,014	5,070
Sales/redemptions	(8,563)	(7,055)	(1,508)
After-tax income from affiliated companies	2,455	2,455	–
Dividends declared	(1,328)	(1,328)	–
Translation differences/other changes	(535)	(359)	(176)
Balance as of December 31, 1998	**27,035**	**16,796**	**10,239**

A list of affiliated companies, prepared in accordance with the relevant legal requirements, is deposited at the Commercial Register in Eindhoven, the Netherlands.

D Other non-current financial assets

	total	other marketable securities	other receivables
Balance as of January 1, 1998	33	18	15
Changes:			
Acquisitions/additions	3,447	3,447	–
Sales/redemptions	(4)	(2)	(2)
Value adjustments	(1)	(1)	
Balance as of December 31, 1998	**3,475**	**3,462**	**13**

Included in other non-current financial assets are participations and securities that generate income unrelated to normal business operations.

With regard to the acquisition of the Seagram shares as part of the sale of PolyGram, reference is made to the Group financial statements and the relevant notes.

E Receivables

	1998	1997
Trade accounts receivable	**245**	167
Group companies	**632**	953
Unconsolidated companies	**15**	22
Total	**892**	1,142

Other receivables	**393**	99
Advances and prepaid expenses	**34**	9
Deferred tax assets	**181**	118
Income tax receivable	**69**	168
Total	**1,569**	1,536

An amount of NLG 325 million included in other receivables is due after one year (1997: NLG 70 million). Income tax receivable amounting to NLG 3 million is due after one year (1997: NLG 89 million).

F Stockholders' equity

Reference is made to the Group financial statements and related notes.

No legal reserve for undistributed income from affiliated companies is required on the basis of the 'collective method', taking into account dividend distributions by affiliated companies, the receipt of which can be effected without restrictions.

G Provisions

	1998	1997
Pensions	**185**	179
Other	**50**	41
Total	**235**	220
Of which long-term	**233**	215
Of which short-term	**2**	5

As almost all obligations in connection with pension plans have been covered by separate pension funds or third parties, the provision for pensions refers to additional payments which the Company intends to make in the future.

H Long-term debt

	range of interest rates	average rate of interest	amount outstanding	due in 1999	due after 1999	due after 2003	average remaining term (in years)
Convertible debentures	1.2	1.2	167	–	167	–	4.0
Other debentures	5.6 – 8.8	7.0	4,783	–	4,783	3,128	7.0
Intercompany financing	1.3 – 7.3	3.3	1,916	1,916	–	–	–
Other long-term debt	5.4 – 7.0	5.9	323	62	261	71	4.3
Total		**6.0**	**7,189**	**1,978**	**5,211**	**3,199**	
Corresponding data previous year		6.9	7,578	1,884	5,694	3,879	

The following amounts of the long-term debt as of December 31, 1998, are due in the next five years:

1999	1,978
2000	296
2001	884
2002	440
2003	392
	3,990
Corresponding amount previous year	3,699

Included in convertible debentures are Philips personnel debentures, for which reference is made to the related note in the Group accounts.

I Short-term debt

Short-term debt includes the current portion of outstanding debt amounting to NLG 409 million (1997: NLG 71 million) and debt to other group companies totaling NLG 5,308 million (1997: NLG 4,252 million).

J Other liabilities

	1998	1997
Other short-term liabilities	**115**	69
Deferred income and accrued expenses	**270**	314
Total	**385**	383

K Net income

Current-year net income is NLG 13,339 million (1997: net income of NLG 5,733 million). For the remuneration of past and present members of both the Board of Management and the Supervisory Board, reference is made to the statement on page ... of the consolidated financial statements.

L Employees

The number of persons employed by Royal Philips Electronics at year-end 1998 was 16 (1997: 13) and included the members of the Board of Management and most members of the Group Management Committee.

M Obligations not appearing in the balance sheet

General guarantees as defined in Book 2, Section 403 of the Netherlands Civil Code have been given by Royal Philips Electronics on behalf of several Group companies in the Netherlands. The liabilities of these companies to third parties and unconsolidated companies totaled NLG 3,489 million as of year-end 1998 (1997: NLG 3,092 million). Guarantees totaling NLG 2,913 million (1997: NLG 3,582 million) have also been given on behalf of other Group companies, and guarantees totaling NLG 322 million (1997: NLG 332 million) on behalf of unconsolidated companies and third parties.

Eindhoven, February 9, 1999

The Supervisory Board

The Board of Management

Auditors' report

Introduction

We have audited the 1998 financial statements of Koninklijke Philips Electronics N.V. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 1998 and of the results of its operations for the year then ended in accordance with accounting principles generally accepted in the Netherlands and comply with the financial reporting requirements included in Part 9, Book 2 of the Netherlands Civil Code.

Eindhoven, February 9, 1999
KPMG Accountants N.V.

Subsequent event

On September 27, 1998, Philips signed a preliminary agreement with an affiliate of Compass Partners International to sell its conventional (non-ceramic) Passive Components business group. The transaction was concluded on January 14, 1999 and resulted in a gain of NLG 0.3 billion, while the relating cash proceeds of NLG 0.8 billion were received in January 1999.

Proposed distribution of income of Royal Philips Electronics

Pursuant to article 39 of the Articles of Association, NLG 12,545 million of the income for the financial year 1998 shall be retained by way of reserve. A proposal will be submitted to the General Meeting of Shareholders to declare a dividend of NLG 2.20 per common share from the remaining portion of NLG 794 million.

Proposed share reduction program

As part of the share reduction program and apart from the dividend proposal, a proposal will be submitted to the General Meeting of Shareholders to convert part of the surplus paid-in capital into nominal share capital and subsequently to reduce the nominal share capital by distributing a cash amount of NLG 3.3 billion or NLG 9.07 per common share to all Philips' shareholders. This program will be combined with redenomination of the share capital to a par value of 1 euro and is expected to be effected mid-1999.

Information on the Millennium Program

In 1996, Philips established the Philips Millennium Program to address year 2000 issues. These issues relate to business continuity risks in Philips' integral national and international business chains, including the supply base and customer base, caused by systems, products and equipment containing date-sensitive components failing to recognize the year 2000. The Corporate Millennium Office, which is headed by a senior executive who reports directly to the Chief Financial Officer, is responsible for supervising the program. The Corporate Millennium Office monitors the program's headway and regularly provides progress reports to the Board of Management.

State of readiness

The program has been designed and developed from the business perspective, integrating progressively the internal and external risk factors in the integral business chains, which operate in many different national and regional environments. The program identifies seven interrelated Millennium impact areas: customer base; supply base; IT applications; IT infrastructure; facilities and services; corporate core processes; and countries and regions. The program prescribes a standard procedure comprising the following phases: 1. business impact analysis; 2. strategy definition and action planning; and 3. execution (including remediation, testing and, where applicable, contingencies). All sectors and groups in the Company, such as the businesses, countries and regions and corporate departments, tailor the program as appropriate for these seven impact areas. Dedicated staff, supported by external solution and service providers, are active worldwide. The status of the program in each impact area is summarized below.

- *Customer base.* This impact area consists of Philips' past and present customers. Product compliance has been confirmed by the businesses for up to 90% of all products. The rest will be confirmed before July 1, 1999. With regard to the processes linking Philips' businesses with their key customers, phase 1 has been completed. Phases 2 and 3, which mainly focus on contingencies and joint activities, will be finalized before September 1, 1999.
- *Supply base.* This impact area consists of Philips' past and present suppliers. The product compliance issue focuses, at this stage, on IT equipment and manufacturing equipment. Overall, product compliance is approximately 70%-assured, often on the basis of additional in-house testing. The remainder will be finalized by July 1, 1999. With regard to the processes linking Philips' businesses with their key suppliers, phase 1 has been completed. Phases 2 and 3, which mainly focus on contingencies and joint activities, will be finalized before September 1, 1999.
- *IT applications and IT infrastructure.* These impact areas include application software, as well as hardware and system software. Phases 1 and 2 have been finalized in these areas. Phase 3 was approximately 60% complete by the end of 1998. The remaining phase 3 work will be done during the first half of 1999. Final testing is based upon time-travel-testing on Millennium-compliant test platforms, supported by Origin and external IT suppliers.
- *Facilities and services.* This impact area consists of buildings, sites and plants, and their internal and external environments. Phase 1 has been finalized; phase 2 is 70% ready; phase 3 is 40% ready. All remaining actions will be completed by July 1, 1999. This impact area also comprises shop-floor equipment and processes. Phase 1 has been finalized; phase 2 is 70% ready; phase 3 is 50% ready. All remaining actions will be completed by July 1, 1999.
- *Corporate core processes.* This impact area relates to the corporate core processes which are standardized worldwide, e.g. Control, Treasury, Management Development, Audit, etc. Phases 1 and 2 are 80% complete. Phase 3, which mainly focuses on local external risks such as banking services and communications, is 50% ready. All remaining actions, including contingencies, will be finalized before August 1, 1999.
- *Countries and regions.* In accordance with the allocation of tasks and responsibilities under the Company's governance model, this impact area focuses on minimizing local external risks, e.g. utilities, transportation, customs services, facilities services, communications and banking services. Phase 1 will be completed by March 1, 1999. Phases 2 and 3 will be completed before September 1, 1999.

Costs

The costs associated with the program are congruent with Philips' ongoing efforts to improve its IT systems and business processes and will provide future benefits to its operations. The Company estimates that the total cost of addressing the year 2000 issues will be approximately NLG 600 million. Major expenditures include the modification and testing of software (NLG 200 million), the hiring of external solution providers (NLG 25 million), the accelerated implementation of new systems (NLG 75 million), the replacement of non-compliant systems (NLG 250 million) and other non-IT costs (NLG 50 million). Since the program's inception in 1996 through the end of 1998, the Company has spent approximately NLG 350 million. The Company expects to incur further expenses totaling approximately NLG 250 million. Certain costs related to contingencies and joint activities with third parties (including suppliers and customers), which will be incurred after 2000, can be estimated only towards the end of 1999 and are therefore not included in the above amounts.

Philips undertakes a review of costs and expenditures related to the program on a quarterly basis. As further reviews are made, and because cost forecasts are predicated on assumptions of future events (many of which are outside the control of management), estimates of the program's costs may change. Although at present the Company does not expect the impact of year 2000 costs to have a material effect on the results of operations, actual results could be adversely impacted if the estimated costs rise by significant amounts.

Risks

Although the Company has dedicated significant resources to minimize year 2000 risks, the program's goal of complete year 2000 compliance may not be fully achieved. Any failure to correct all year 2000 problems may result in the interruption or cessation of normal business operations. Such a disruption of business continuity could arise due to a number of factors – (i) loss or corruption of data within Philips' internal information systems, (ii) operational failure of Philips' hardware and (iii) development of health, environmental and safety issues arising in connection with Philips' facilities – and could adversely affect the Company's results, liquidity or financial condition. Nevertheless, the Company views the likelihood of disruption of business continuity as a result of such internal risk factors as relatively small. However, due to the risks inherent in a number of external year 2000 issues, over which the Company has no control or for which no precedents exist, the Company is unable to determine at this time the likelihood of a material impact on its performance. One such issue is that the Company may have either inaccurately assessed or been unable to assess all external risk factors, including the degree of third parties' year 2000 preparedness. Since the beginning of 1998, Philips has been striving to minimize its exposure in this area by obtaining, where possible, assurances from third parties (including customers, suppliers and governmental agencies) of their Millennium readiness and by developing joint actions and contingencies where applicable.

However, because Philips is neither able nor allowed to perform detailed reviews of all such third parties, it cannot determine with accuracy the level of their year 2000 readiness. Because the Company is reliant on these parties for the provision of water, energy, banking services, communication services, transportation, customs services, parts and raw materials, as well as other products and services, Philips' operations may be adversely impacted if year 2000 problems prevent these parties from being able to provide such items and services. Furthermore, it is predicted that year 2000 readiness issues will result in a significant amount of litigation. For example, Philips may become involved in third-party claims due to a material interruption or failure of any of its services or products resulting from year 2000 problems. While the outcome and impact of such litigation is impossible to predict due to its unprecedented nature, it may have a materially adverse effect on the Company. Finally, Philips' products may contain undetected year 2000 problems, and the Company cannot give assurances as to the absence of any such defects.

Although the Company has taken what it believes are reasonable, prudent measures to mitigate these risks through the implementation of the program, the Company can give no assurances that such measures will be sufficient to prevent a materially adverse impact on its operations, liquidity and financial condition. The Company expects that the program's progression will result in reduced uncertainty relating to the Company's year 2000 compliance and a reduced likelihood of interruptions to its operations.

Contingencies

The Company's contingency policy is designed to alleviate the potential harm that could result from both internal and external risks. Because the Company believes that external risks could exert a more damaging impact on business performance than internal risks, the contingency policy focuses on the former. The Company is in the process of gathering information and qualitatively analyzing these facts to develop a contingency plan to address such risks as the cessation or interruption of utilities, banking, communication, transportation and customs services. Philips' businesses are working to coordinate their respective contingency plans with key suppliers and customers and are specifically considering such elements as logistics, activity scheduling, maintenance and overhaul scheduling, and staff and holiday planning. The Company anticipates having contingency plans to minimize the external risks in place by the third quarter of 1999. With regard to the internal risks, the contingency plans being prepared include an optimized activity schedule for the millennium roll-over, the presence of dedicated support teams on all sites, and the availability of alternative means of communication.

Cautionary statement

The Company has made forward-looking statements regarding the program. These statements include: (i) the Company's expectations about when it will be year 2000 compliant; (ii) the Company's expectations about the impact of the year 2000 problem on its ability to continue to operate on and after January 1, 2000; (iii) the readiness of its suppliers; (iv) the costs associated with the program; and (v) a discussion of worst-case scenarios. The Company has described many of the risks associated with the above forward-looking statements. However, there are many factors that could cause actual results to differ materially from those stated in the forward-looking statements. This is especially the case because many aspects of the program are outside its control, such as the performance of many thousands of third-party suppliers and of customers and users. As a global company, Philips operates in many different countries; however, the year 2000 problem is not being addressed to the same extent everywhere. As a result, there may be unforeseen problems in different parts of the world. All of these factors make it impossible for the Company to ensure it will be able to resolve all year 2000 problems in a timely manner to prevent them having a materially adverse effect on its operations or business or exposing the Company to third-party liability.

General

Koninklijke Philips Electronics N.V. (the 'Company') is the parent company of the Philips Group. Its shares are listed on the Amsterdam Exchanges, the New York Stock Exchange, the London Stock Exchange and several other stock exchanges.

The management of the Company is entrusted to the Board of Management under the supervision of the Supervisory Board. The activities of the Philips Group are organized in product divisions, which are responsible for the worldwide business policy. Philips has more than 225 production sites in over 25 countries and sales and service outlets in some 150 countries. It delivers products, systems and services in the fields of lighting, consumer electronics and communications, domestic appliances and personal care, components, semiconductors, medical systems, business electronics and information technology. The Company's activities are grouped in seven sectors: Lighting, Consumer Products, Components, Semiconductors, Professional, Origin and Miscellaneous. The statutory list of all subsidiaries and affiliated companies, prepared in accordance with the relevant legal requirements (The Netherlands Civil Code, Book 2, Articles 379 and 414), forms part of the notes to the financial statements and is deposited at the office of the Commercial Register in Eindhoven, the Netherlands (file no. 1910).

In their reports to shareholders, both the Board of Management and the Supervisory Board referred to the progress made in recent years in improving the governance of the Company and the Philips Group, in particular in respect of the supervisory function, the rights of shareholders and transparency. These improvements were in response to developments in the international capital markets, such as the United States, where its shares have been traded since 1962 and listed on the New York Stock Exchange since 1987. Philips also generally endorses the recommendations of the Committee of the Amsterdam Exchanges of October 1997 on best practices in corporate governance.

Board of Management and Supervisory Board

The Board of Management is responsible for the effective management of the business. It is required to keep the Supervisory Board informed of developments, to consult it on important matters and to submit certain important decisions to it for its prior approval. The Board of Management consists of at least three members (currently eight), who are elected for an indefinite period by the General Meeting of Shareholders. The President is appointed by the General Meeting of Shareholders. Members of the Board of Management may be suspended by the Supervisory Board and the General Meeting of Shareholders and dismissed by the latter. The remuneration of the members of the Board of Management is determined by the Supervisory Board upon a proposal from the President and on the advice of the Remuneration Committee of the Supervisory Board.

The Supervisory Board is independent of the Board of Management and is responsible for supervising both the policies of the Board of Management and the general direction of the Group's business. It is also required to advise the Board of Management. The Supervisory Board consists of at least five members (currently eight). They elect a Chairman, Vice-Chairman and Secretary from their midst. The Board has three permanent committees: an Audit Committee, a Remuneration Committee and a Nomination and Selection Committee. These committees advise the plenary Supervisory Board. Members of the Supervisory Board are appointed by the General Meeting of Shareholders for fixed terms of four years, and may be re-elected for two additional four-year terms. In exceptional cases, however, the Supervisory Board and the Meeting of Priority Shareholders may deviate from this rule. At the latest, members retire upon reaching the age of 72. Members of the Supervisory Board may be suspended or dismissed by the General Meeting of Shareholders. Their remuneration is fixed by the General Meeting of Shareholders.

The appointment of the members of the Board of Management and the Supervisory Board by the General Meeting of Shareholders is upon a binding recommendation from the Supervisory Board and the Meeting of Priority Shareholders. However, this binding recommendation may be overruled by a resolution of the General Meeting of Shareholders taken by a majority of at least 2/3 of the votes cast and representing more than half of the issued share capital.

Group Management Committee

The Group Management Committee consists of the members of the Board of Management, certain Chairmen of product divisions 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 the Company and to define and implement common policies.

General Meeting of Shareholders

A General Meeting of Shareholders is held at least once a year to discuss and resolve on the report of the Board of Management, the financial statements, the report of the Supervisory Board, any proposal concerning dividends or other distributions, and any other matters proposed by the Board of Management or the Supervisory Board. This meeting is held in Eindhoven, Amsterdam, Rotterdam or The Hague no later than six months after the end of the financial year. Meetings are convened by public notice and mailed to registered shareholders. Extraordinary General Meetings may be convened by the Supervisory Board or the Board of Management if necessary or if requested by the Meeting of Priority Shareholders or shareholders representing at least 10% of the outstanding capital. The agenda of the General Meeting is drawn up by the Board of Management and the Supervisory Board. Requests from shareholders for items to be included on the agenda will be honored, provided that such requests are made to the Board of Management and the Supervisory Board by shareholders representing at least 1% of the Company's outstanding capital at least 60 days before a General Meeting of Shareholders and provided that the Board of Management and the Supervisory Board are of the opinion that such requests are not detrimental to the serious interests of Philips.

The main powers of the General Meeting of Shareholders are to appoint, suspend and dismiss members of the Board of Management and the Supervisory Board, to adopt the financial statements and to discharge the Board of Management and the Supervisory Board from reponsiblity for performing their respective duties for the previous financial year, to adopt amendments to the Articles of Association and proposals to dissolve or liquidate the Company, to issue shares or rights to shares, to restrict or pass pre-emptive rights of shareholders and to repurchase or cancel outstanding shares. Following common practice, the Company each year requests limited authorization to issue (rights to) shares, to pass pre-emptive rights and to repurchase shares.

Meeting of Priority Shareholders and the Dr. A.F. Philips-Stichting

There are ten priority shares. Eight are held by the Dr. A.F. Philips-Stichting, with Mr F.J. Philips and Mr H.A.C. van Riemsdijk each holding one. The self-electing Board of the Dr. A.F. Philips-Stichting consists of the Chairman and the Vice-Chairman and Secretary of the Supervisory Board, any further members of the Supervisory Board, and the President of the Company. At present, the Board consists of Mr F.A. Maljers, Mr A. Leysen, Mr L.C. van Wachem, Mr C.J. Oort and Mr C. Boonstra.
A Meeting of Priority Shareholders is held at least once a year, at least thirty days before the General Meeting of Shareholders. Approval of the Meeting of Priority Shareholders is required for resolutions of the General Meeting of Shareholders regarding the issue of shares or rights to shares, the cancellation of shares, amendments to the Articles of Association, and the liquidation of the Company. Acting in agreement with the Supervisory Board, the Meeting also makes a binding recommendation to the General Meeting of Shareholders for the appointment of members of the Board of Management and the Supervisory Board.

Meeting of Holders of Preference Shares and the Stichting Preferente Aandelen Philips

The authorized share capital of the Company consists of ten priority shares, 500,000,000 ordinary shares and 499,995,000 preference shares. No preference shares have been issued. However, the Stichting Preferente Aandelen Philips ('the Foundation') has been granted the right to acquire preference shares in the Company should a third party ever seem likely to gain a controlling interest in the Company. The Foundation may exercise this right for as many preference shares as there are common shares in the Company outstanding at that time. The object of the Foundation is to represent the interests of the Company, the enterprises maintained by the Company and its affiliated companies within the Philips Group, such that the interests of Philips, those enterprises and all parties involved with them are safeguarded as effectively as possible, and that they are afforded maximum protection against influences which, in conflict with those interests, may undermine the autonomy and identity of Philips and those enterprises, and also to do anything related to the above ends or conducive to them.
The members of the self-electing Board of the Foundation are Messrs J.R. Glasz, H.B. van Liemt, W.E. Scherpenhuijsen Rom, F.A. Maljers and C. Boonstra. As Chairman of the Supervisory Board and the Board of Management respectively, Messrs Maljers and Boonstra are members of the Board ex officio. Mr Boonstra is not entitled to vote.
The Board of Management of the Company and the Board of the Stichting Preferente Aandelen Philips declare that they are jointly of the opinion that the Stichting Preferente Aandelen Philips is independent of the Company as required by the Listing Requirements of the Amsterdam Exchanges N.V. (AEX).

The Philips Group in the last five years *

all amounts in millions of Dutch guilders unless otherwise stated

Due to factors such as consolidations and divestments, the amounts, percentages and ratios are not directly comparable.

General data

	1998	1997	1996	1995	1994
Sales	**67,122**	65,358	59,707	55,664	52,377
Percentage increase over previous year	**3**	9	7	6	2
Income from continuing operations	**1,192**	2,712	278	2,139	1,506
Net income (loss)	**13,339**	5,733	(590)	2,518	2,125
Turnover rate of net operating capital	**2.91**	2.84	2.70	2.88	2.95
Total employees at year-end (in thousands)	**234**	252	250	253	241
Salaries, wages and social costs paid	**18,090**	18,205	17,812	16,225	15,494

Income

	1998	1997	1996	1995	1994
Income from operations	**1,509**	3,777	929	2,975	2,704
As a % of sales	**2.2**	5.8	1.6	5.3	5.2
As a % of net operating capital (RONA)	**6.5**	16.4	4.2	15.4	15.2
Income taxes	**(91)**	(607)	15	(162)	(297)
As a % of income before taxes	**11**	20	(40)	7	16
Income after taxes	**732**	2,467	54	2,125	1,533
As a % of sales	**1.1**	3.8	0.1	3.8	2.9
Income from continuing operations	**1,192**	2,712	278	2,139	1,506
As a % of stockholders' equity (ROE)	**5.2**	16.1	1.9	16.1	12.6
Per common share	**3.31**	7.76	0.81	6.29	4.53
Net income (loss)	**13,339**	5,733	(590)	2,518	2,125
Per common share	**37.05**	16.41	(1.73)	7.41	6.39
Dividend per common share	**2.20**	2.00	1.60	1.60	1.25

* All years have been restated to reflect the sale of PolyGram N.V. and to present the Philips Group accounts on a continuing basis.

Definitions

Net operating capital: intangible assets, property, plant and equipment, non-current receivables and current assets excl. cash and cash equivalents and deferred tax positions, after deduction of provisions (with the exception of pension liabilities) and other liabilities

RONA: income from operations as a % of average net operating capital

ROE: income from continuing operations as a % of average stockholders' equity

Net debt: long-term and short-term debt net of cash and cash equivalents

Average number of outstanding shares: weighted average number of outstanding common shares based on monthly positions during the reporting year

Capital employed

	1998	1997	1996	1995	1994
Cash and cash equivalents	**14,441**	3,079	1,731	2,053	2,071
Receivables	**11,992**	12,040	11,832	10,776	10,065
Inventories	**9,419**	9,966	9,550	11,202	9,543
Current assets	**35,852**	25,085	23,113	24,031	21,679
Non-current financial assets	**6,250**	3,198	3,565	2,994	2,769
Net assets discontinued operations	**–**	3,265	2,640	2,232	1,986
Non-current receivables	**4,230**	4,095	3,664	3,114	3,079
Property, plant and equipment (book value)	**14,488**	15,283	14,807	13,429	12,339
Intangible assets (book value)	**1,221**	468	489	436	231
Non-current assets	**26,189**	26,309	25,165	22,205	20,404
Total assets	**62,041**	51,394	48,278	46,236	42,083
Property, plant and equipment:					
Capital expenditures for the year	**3,600**	3,585	4,815	4,688	3,383
Depreciation for the year	**3,560**	3,288	3,168	2,685	2,798
Capital expenditures : depreciation	**1.0**	1.1	1.5	1.7	1.2
Inventories as a % of sales	**14.0**	15.2	16.0	20.1	18.2
Outstanding trade receivables, in months' sales	**1.3**	1.3	1.3	1.5	1.5

Financial structure

	1998	1997	1996	1995	1994
Other current liabilities	**14,939**	13,943	12,711	12,435	11,842
Dividend payable	**794**	716	555	547	421
Debt	**7,905**	8,882	12,903	10,481	8,539
Provisions	**6,578**	7,164	7,537	7,625	7,858
Total provisions and liabilities	**30,216**	30,705	33,706	31,088	28,660
Issued, paid-up capital	**3,685**	3,648	3,525	3,451	3,385
Surplus and reserves	**27,607**	15,809	10,431	10,604	9,298
Stockholders' equity	**31,292**	19,457	13,956	14,055	12,683
Other group equity	**533**	1,232	616	1,093	740
Group equity	**31,825**	20,689	14,572	15,148	13,423
Total equity and liabilities	**62,041**	51,394	48,278	46,236	42,083
Net debt: group equity ratio	*	22:78	43:57	36:64	33:67
Stockholders' equity per common share	**86.76**	54.36	40.21	41.13	37.62
Market price per common share at year-end	**126.00**	121.60	70.00	58.00	51.40

* The current net cash situation renders the net debt to group equity ratio meaningless.

Some key financial information in EUR and USD

all amounts in millions of euro and US dollar unless otherwise stated

Philips' consolidated financial data are presented in Dutch guilders. Certain information is summarized below in euro and in US dollar. The amounts in guilders of the statement of income and cash flow items have been converted at average rates, while the balance sheet amounts have been converted at the official rates as of December 31, 1998 and 1997. The conversion rates used have been listed in the table below.

Statement of income

	EUR*		USD	
	1998	1997	**1998**	1997
Sales	**30,459**	29,658	**33,900**	33,517
Income from operations	**685**	1,714	**762**	1,937
Financial income and expenses	**(312)**	(319)	**(346)**	(361)
Income before taxes	**373**	1,395	**416**	1,576
Income taxes	**(41)**	(276)	**(46)**	(311)
Income after taxes	**332**	1,119	**370**	1,265
Results relating to unconsolidated companies	**39**	94	**43**	106
Share of other group equity in group income	**170**	18	**189**	20
Income from continuing operations	**541**	1,231	**602**	1,391
Per common share	**1.50**	3.52	**1.67**	3.98
Net income	**6,053**	2,602	**6,737**	2,940
Per common share	**16.81**	7.45	**18.71**	8.42

Balance sheet as of December 31

	EUR* 1998	EUR* 1997	USD 1998	USD 1997
Cash and cash equivalents	**6,553**	1,397	**7,641**	1,524
Receivables	**5,442**	5,464	**6,345**	5,960
Inventories	**4,274**	4,522	**4,983**	4,934
Non-current assets	**11,884**	11,939	**13,857**	13,025
Total assets	**28,153**	23,322	**32,826**	25,443
Other current liabilities	**7,139**	6,653	**8,324**	7,258
Debt	**3,587**	4,030	**4,183**	4,397
Provisions	**2,985**	3,251	**3,480**	3,546
Total provisions and liabilities	**13,711**	13,934	**15,987**	15,201
Stockholders' equity	**14,200**	8,829	**16,557**	9,632
Other group equity	**242**	559	**282**	610
Group equity	**14,442**	9,388	**16,839**	10,242
Total equity and liabilities	**28,153**	23,322	**32,826**	25,443
Stockholders' equity per common share	**39.37**	24.67	**45.90**	26.91
Cash flow statement				
Net cash provided by operating activities	**2,140**	3,210	**2,381**	3,627
Net cash (used for) provided by investing activities	**(1,441)**	45	**(1,604)**	51
Net cash used for financing activities	**(814)**	(2,661)	**(906)**	(3,007)
Conversion rates in Dutch guilders:				
Average	**2.20371**	2.20371	**1.98**	1.95
Year-end	**2.20371**	2.20371	**1.89**	2.02

* For the convenience of the reader, the Dutch guilder amounts of all financial information presented in the table have been converted into euro at the fixed rate for both years 1998 and 1997.

Quarterly statistics

all amounts in millions of Dutch guilders unless otherwise stated.

	1998				1997			
	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Sales	15,552	16,401	16,126	19,043	13,932	14,928	16,205	20,293
- % increase	12	10	0	(6)	2	7	16	11
Income from operations	822	1,029	511	(853)	644	924	1,047	1,162
- as % of sales	5.3	6.3	3.2	(4.5)	4.6	6.2	6.5	5.7
- % increase	28	11	(51)	.	29	.	.	.
Income before taxes	684	896	283	(1,040)	481	700	886	1,007
- as % of sales	4.4	5.5	1.8	(5.5)	3.5	4.7	5.5	5.0
- % increase	42	28	(68)	.	72	.	.	.
Income after taxes	530	687	218	(703)	370	535	670	892
- as % of sales	3.4	4.2	1.4	(3.7)	2.7	3.6	4.1	4.4
- % increase	43	28	(67)	.	54	.	.	.
Income from continuing operations	707	840	324	(679)	371	585	660	1,096
- % increase	91	44	(51)	.	30	.	.	.
- per common share (in NLG)	1.97	2.33	0.89	(1.88)	1.06	1.68	1.89	3.13
Net income	1,561	1,033	425	10,320	887	747	1,432	2,667
- % increase	76	38	(70)	.	28	.	.	.
- per common share (in NLG)	4.36	2.86	1.17	28.66	2.55	2.14	4.09	7.63

	January-March	January-June	January-September	January-December	January-March	January-June	January-September	January-December
Sales	15,552	31,953	48,079	67,122	13,932	28,860	45,065	65,358
- % increase	12	11	7	3	2	5	9	9
Income from operations	822	1,851	2,362	1,509	644	1,568	2,615	3,777
- as % of sales	5.3	5.8	4.9	2.2	4.6	5.4	5.8	5.8
- % increase	28	18	(10)	(60)	29	89	.	.
- as a % of net operating capital (RONA)	3.5	7.8	10.0	6.5	2.9	6.8	11.2	16.4
Income before taxes	684	1,580	1,863	823	481	1,181	2,067	3,074
- as % of sales	4.4	4.9	3.9	1.2	3.5	4.1	4.6	4.7
- % increase	42	34	(10)	(73)	72	.	.	.
Income after taxes	530	1,217	1,435	732	370	905	1,575	2,467
- as % of sales	3.4	3.8	3.0	1.1	2.7	3.1	3.5	3.8
- % increase	43	34	(9)	(70)	54	.	.	.
Income from continuing operations	707	1,547	1,871	1,192	371	956	1,616	2,712
- as a % of stockholders' equity (ROE)	16.9	17.4	13.4	5.2	10.8	13.3	14.3	16.1
- per common share (in NLG)	1.97	4.30	5.19	3.31	1.06	2.74	4.63	7.76
Net income	1,561	2,594	3,019	13,339	887	1,634	3,066	5,733
- % increase	76	59	(2)	.	28	.	.	.
- per common share (in NLG)	4.36	7.22	8.39	37.05	2.55	4.69	8.78	16.41
Depreciation of property, plant and equipment	784	1,597	2,449	3,560	752	1,587	2,394	3,288

	1998				1997			
Inventories as a % of sales	16.9	17.1	17.5	14.0	17.9	18.9	19.1	15.2
Average collection period of trade receivables in months' sales	1.6	1.6	1.6	1.3	1.7	1.6	1.6	1.3
Net debt : group equity ratio	18:82	21:79	21:79	*	40:60	40:60	34:66	22:78
Total employees (in thousands)	255	255	256	234	254	253	257	252

* The current net cash situation renders the net debt to group equity ratio meaningless.

Consolidated statements of income and cash flows

all amounts in millions of Dutch guilders unless otherwise stated

Consolidated statements of income

	4th quarter 1998	4th quarter 1997	January-December 1998	January-December 1997
Sales	**19,043**	20,293	**67,122**	65,358
Income from operations	**(853)**	1,162	**1,509**	3,777
Financial income and expenses	**(187)**	(155)	**(686)**	(703)
Income before taxes	**(1,040)**	1,007	**823**	3,074
Income taxes	**337**	(115)	**(91)**	(607)
Income after taxes	**(703)**	892	**732**	2,467
Results relating to unconsolidated companies	**(7)**	146	**86**	206
Share of other group equity in group income	**31**	58	**374**	39
Income from continuing operations	**(679)**	1,096	**1,192**	2,712
Per common share (in NLG)	**(1.88)**	3.13	**3.31**	7.76
Discontinued operations	**314**	321	**462**	579
Gain on discontinued operations	**10,675**		**10,675**	
Extraordinary items – net	**10**	1,250	**1,010**	2,442
Net income	**10,320**	2,667	**13,339**	5,733
Per common share (in NLG)	**28.66**	7.63	**37.05**	16.41

Consolidated statements of cash flows

	4th quarter 1998	4th quarter 1997	January-December 1998	January-December 1997
Cash flows from operating activities:				
Net income	**10,320**	2,667	**13,339**	5,733
Income from discontinued operations	**(314)**	(321)	**(462)**	(579)
Net gain on disposal of discontinued operations	**(10,675)**	–	**(10,675)**	–
Depreciation and amortization	**1,650**	974	**4,164**	3,520
Net gain on sale of investments	**(111)**	(1,466)	**(1,604)**	(3,070)
Increase in working capital	**2,709**	2,644	**695**	796
Decrease in provisions	**(282)**	(231)	**(390)**	(246)
Other items	**(209)**	246	**(352)**	919
Net cash generated by operating activities	**3,088**	4,513	**4,715**	7,073
Cash required for investments	**(2,771)**	(1,382)	**(5,510)**	(4,161)
Proceeds from divestments	**513**	1,240	**2,335**	4,261
Cash flows (before financing activities)	**830**	4,371	**1,540**	7,173

Segment revenues and income from operations by product sector and by geographic area

Product sector

	4th quarter 1998 segment revenues	4th quarter 1998 income (loss) from operations	4th quarter 1997 segment revenues	4th quarter 1997 income (loss) from operations	January-December 1998 segment revenues	January-December 1998 income (loss) from operations	January-December 1997 segment revenues	January-December 1997 income (loss) from operations
Lighting	2,683	334	2,828	290	9,925	1,311	10,141	1,151
Consumer Products	8,198	(709)	9,125	266	28,120	(613)	26,871	738
Components	3,092	(132)	3,230	120	11,590	98	11,237	562
Semiconductors	2,094	309	2,326	420	8,732	1,687	8,359	1,700
Professional	3,365	(362)	3,158	269	10,245	(122)	9,816	456
Origin	1,054	59	882	32	3,645	130	2,918	0
Miscellaneous	635	(43)	1,281	48	2,507	(102)	4,632	30
Costs and revenues not allocated		(309)		(283)		(880)		(860)
Total	21,121	(853)	22,830	1,162	74,764	1,509	73,974	3,777
Intersegment sales	(2,078)		(2,537)		(7,642)		(8,616)	
Sales	19,043		20,293		67,122		65,358	
Income from operations as a % of sales		(4.5)		5.7		2.2		5.8

Geographic area

	4th quarter 1998 segment revenues	4th quarter 1998 income (loss) from operations	4th quarter 1997 segment revenues	4th quarter 1997 income (loss) from operations	January-December 1998 segment revenues	January-December 1998 income (loss) from operations	January-December 1997 segment revenues	January-December 1997 income (loss) from operations
Europe	18,771	268	17,796	878	63,221	2,387	58,311	2,352
USA and Canada	5,400	(734)	5,553	50	18,891	(1,042)	16,846	23
Latin America	865	(378)	1,206	(201)	4,436	(451)	4,637	(122)
Africa	76	(2)	72	4	278	(2)	250	7
Asia	5,710	(10)	6,714	463	22,065	632	23,807	1,548
Australia and New-Zealand	252	3	283	(32)	923	(15)	1,316	(31)
Total	31,074	(853)	31,624	1,162	109,814	1,509	105,167	3,777
Interregional sales	(12,031)		(11,331)		(42,692)		(39,809)	
Sales	19,043		20,293		67,122		65,358	
Income from operations as a % of sales		(4.5)		5.7		2.2		5.8