



Improving lives, delivering value

Sustainability Report 2006

PHILIPS

98%
of risk suppliers audited

24%
more Green Flagships products



1st
position Dow Jones Sustainability
Index sector leisure goods

Our focus

At Philips we improve the quality of people's lives through the timely introduction of meaningful **innovations**. Focusing on key global challenges – the growing demands for **healthcare** and **energy efficiency** – we use our expertise to develop sustainable solutions for people in all markets. It's all about **delivering value** for individuals, communities and the company.

8%

of total sales from
Green Flagships



9,000,000,000+

people sharing this planet by 2050

Forward-looking statements

This report contains forward-looking statements with respect to the financial conditions, results of operations and business of Philips and certain of the plans and objectives of Philips with respect to these items. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements.

Statements regarding market share, including as to Philips' competitive position, contained in this document are based on outside sources such as specialized research institutes, industry and dealer panels, etc., in combination with management estimates. Rankings are based on sales unless otherwise stated.

Interviews

Philips does not necessarily agree with the opinions of those quoted for articles in this report.

Contents

6	Philips at a glance
8	Interview with the President
12	The energy challenge
20	Healthcare solutions
28	Supporting development
36	The Philips Way
44	Our employees
52	Our environmental performance
58	Our economic performance
62	Our suppliers
68	Appendixes
75	How to reach us

Contact us

Reader comments are a valuable part of the reporting process. You are invited to support our ongoing improvement efforts by giving us your feedback. Please contact the Corporate Sustainability Office via our website ➔ www.philips.com/sustainability or by e-mail at philips.sustainability@philips.com

Philips at a glance



Since Anton and Gerard Philips founded our company in 1891 in Eindhoven, the Netherlands, we have dedicated ourselves to the lives of people inside and outside the company. Today we are a global company, committed to enhancing economic prosperity, environmental quality and social equity wherever we operate. And we remain dedicated to the belief that the path to true growth comes from making products that genuinely meet the needs of all people, no matter what their circumstances, in ways that truly help them.

Mission

We improve the quality of people's lives through the timely introduction of meaningful innovations

Our values

- Delight customers
- Deliver on commitments
- Develop people
- Depend on each other

Our brand

Delivering on our "sense and simplicity" brand promise, we provide solutions that are designed around you, easy to experience and advanced

Our organization

Headquartered in Amsterdam

- Medical Systems
- Domestic Appliances and Personal Care
- Consumer Electronics
- Lighting
- Other Activities

Our employees

- Multinational workforce of 121,700
- 65% male / 35% female
- 6% female executives
- General Business Principles established in 1998
- Frontrunner in social provisions for employees, beginning in 1900



Strong innovation base

- Founded in 1914, Philips Research is one of the world's major private research organizations
- Laboratories in Europe, East Asia and North America
- 11 research and development centers in China
- Total R&D expenditure of EUR 1,668 million or 6.2% of sales
- The owner of more than 80,000 patents
- Approximately 1,900 new patents a year
- Breakthrough inventions include the Compact Cassette system and the laser based optical systems CD-Audio, CD-ROM, CD-R/RW, SACD and various DVD-formats

Market leadership

- Number 1 in global lighting
- Number 1 in medical diagnostic imaging and patient monitoring
- Among the world's top-3 consumer electronics companies in served markets
- Number 1 and 2 in male shaving, beauty, oral healthcare, food and beverage and garment care

Financial highlights 2006

	EUR millions
Sales	26,976
Market capitalization	31,600
Earnings before interest and tax	1,183
Net income	5,383
Cash flow from operations	342
Net capital expenditures	697
Net debt to group equity (ratio)	(10):110

Sustainability recognition

- Dow Jones Sustainability Indexes member since 2000
- 2006/2007 DJSI global leader in sector leisure goods
- Global 100 Most Sustainable Corporations in the World since it was launched at the World Economic Forum in 2005

Longstanding environmental commitment

- 1970 Participation in Club of Rome Board of Management Guidelines for Environmental Performance
- 1987 First Global Environmental Policy
- 1993 Membership in World Business Council for Sustainable Development
- 1994 Environmental Opportunity Program (first four-year action program)
- 1998 World Environment Center Gold Medal for International Corporate Environmental Achievement and introduction of first EcoVision program
- 2002 EcoVision II
- 2006 EcoVision III (2006-2009)
57 new Green Flagship products launched
EUR 2.2 billion revenues from Green Flagships

Our suppliers

- Total spend of EUR 18.7 billion
- 25,000 suppliers
- Active Supplier Sustainability Program
- 365 audits for sustainability risk suppliers

Interview with the President

How would you define sustainability at Philips?

It's no different than our company mission – to improve the quality of people's lives through the timely introduction of meaningful innovations. Sustainability is an integral part of the way we do business. We are actually in a unique position because sustainability has always been in our DNA. Our company's founders never lost sight of their employees or the communities they came from. From the early days they provided pensions, sick pay and medical care. They built housing for employees in Eindhoven, and set up sporting and cultural activities. They also provided elementary and secondary schools, and a foundation to finance college scholarships for employees' children. I myself benefited from a Philips scholarship during my studies.

What does this mean today?

Our company has changed a lot over the years, but as for sustainability, we are loyal to our roots. We still put people at the center of our activities. That's what our brand promise of "sense and simplicity" is all about – making technology easier to experience and designed around people, while still being advanced. We need new innovations to improve people's lives in advanced and new and emerging markets, including developing countries. We want to be a company that simplifies solutions for complex issues like sustainable development.

Sounds like quite a challenge.

It is indeed. I believe that because sustainability is such a broad subject, it's critical to simplify it by concentrating on areas where we can really make an impact with our know-how and capabilities. Equally important is the need to look outside, at the bigger picture, and understand the societal trends that are set to define global economic development. This analysis is necessary to capture growth opportunities and that's exactly how we view sustainability – as a business opportunity. An opportunity to improve people's lives and create value for individuals, communities and the company.

So what areas are you concentrating on to deliver value?

We are focusing on two global challenges that affect everyone on the planet: energy and healthcare. Our solutions to these pressing needs include innovations for the entire population pyramid.

Tell us about healthcare in these markets.

Macro-economists forecast that healthcare will be one of the main drivers in the next phase of economic development. But, related to this expectation, healthcare also faces major issues worldwide. An aging and more demanding population in the developed world poses increasing challenges to keep the cost of healthcare systems under control. On the other hand, in new and emerging economies the matter of improving the sheer access to healthcare becomes more urgent almost by the day. So the challenges we face are multifaceted. This means that solutions need to be diverse, tailored to the specific situation.

What is Philips doing to meet these global healthcare challenges?

We are following several complementary routes on this journey. One is by developing new and better methods for early detection of diseases. Early detection and diagnosis means that treatment can be easier and less invasive. This is not only better for the patient, it also leads to lower costs. Working with various universities we are conducting research into molecular imaging. This exciting new field of medicine offers tremendous potential in this area, and eventually is expected to improve treatment by allowing more targeted, effective therapy.

Telemonitoring is another part of our approach. Many patients need help in managing complex conditions over time. Treating these patients is a time- and resource-consuming task for healthcare professionals and usually requires patients to regularly visit healthcare facilities. We've developed a remote patient management solution

“We need new innovations to improve people’s lives in advanced and new and emerging markets.”





designed to deliver personalized healthcare content through home television. This new personal healthcare solution can empower patients to take better care of their health, facilitate more effective care delivery models and reduce the overall costs of treating patients with chronic diseases.

What about health solutions in new and emerging markets?

While we are indeed focusing on these markets, it is important to note that research and innovation for advanced countries can also be of benefit to new and emerging markets. The International Policy Network has noted that low-income countries benefit from treatments originally developed for wealthier countries. At the same time, we know that if we are able to develop smart products and solutions tailored to the specific needs of these economies, we could make a tremendous contribution to improving the lives of a great number of people.

We try to do that in various ways. In China, for example, we are working in a joint venture with a local partner, Neusoft, to develop and produce solid but inexpensive medical equipment for new and emerging economies.

To improve people's health in developing countries we are working on a variety of projects to make healthcare available and combat diseases of poverty.

Let's turn to the global energy challenge.

This is another significant opportunity to improve lives and deliver value. We know that in the next 50 years world population will increase to between 9 and 11 billion people. This, along with the growth in emerging economies, will mean energy and material consumption will grow substantially, placing additional strains on our ecosystems. Today energy needs continue to rise, as do concerns about climate change. I think it's safe to say that the question of global energy needs and the

associated issue of CO₂ emissions are on everyone's minds these days.

What is Philips doing to meet this challenge?

Here, too, we are following several paths. We know that people are paying increasing attention to the environmental aspects of the products they purchase. Our Green Flagship and EcoDesigned products offer environmental performance improvements and we have further increased our focus on the energy efficiency of these products.

I am particularly proud that Philips is leading change in the lighting industry to increase energy efficiency. We are calling for joint action between the lighting industry, non-governmental organizations, energy suppliers and governments to replace the incandescent bulb with the many energy-saving alternatives available today. In December 2006 we announced that we would start this initiative in Europe, where the switch-over could happen in 10 years.

What about lighting in the developing world?

Businesses can clearly play a role in bringing modern lighting to new and emerging markets. We are working with the UN Conference on Trade and Development and local governments to explore opportunities to build a compact fluorescent lamps assembly factory in the Southern African Development Community region – the first of its kind in Africa. Such a plant would provide employment, as well as energy-efficient, affordable lighting solutions to low-income people and give a clear boost to the electrical and electronics sector in this underserved region.

We know from our SMILE (Sustainable Model in Lighting Everywhere) project that modern lighting technologies have significant potential to improve people's livelihoods, and to eliminate the risks of fuel-based lighting.

“I am particularly proud that Philips is leading in the lighting industry to increase energy efficiency.”

In addition to business development, how else does Philips impact people's lives?

As a multinational company with sales and service outlets in 150 countries, we certainly have an impact through our operations. We create jobs, purchase from suppliers and we support the community through our social investment initiatives.

What's more, in areas such as research and development our strategy is guided by the spirit of Open Innovation – intensive, constructive cooperation between different companies, research institutes and universities. Open Innovation is the only way to ensure that we can deliver the solutions that the world needs and that we can get them to market fast. I believe it is the only right way forward in a time where knowledge is spread across the globe among ever more players.

You've given very practical examples of how Philips deals with sustainability. What are your thoughts on the role of corporations in the journey toward sustainable development?

In addition to developing innovations, we see it as our role to bring these benefits to people and communicate about them. Local players help us to identify the needs of our target markets and educate people on the ways our solutions can help. I've mentioned how we cooperate with local organizations and you'll see many examples of such partnerships throughout this report. These relationships are critical.

We also believe it's essential to include local production, local talent and local entrepreneurship. This delivers sustainable business value beyond first-mover advantages and helps the local community move forward. The corporate community must learn to see sustainability not as a nice to do, but as a must do. Companies must realize that, in the long run, there will be a sustainable world with sustainable business or there will be no world and no business at all. That's the ethical challenge for all of us, for multinationals and individuals alike.



Gerard Kleisterlee
President



The energy challenge

Scientists estimate that a 60% to 80% cut in greenhouse gases will be needed to stabilize the atmosphere



“Each one of us is a cause of global warming, but each of us can become part of the solution...”

Al Gore, *An Inconvenient Truth*

In Samoa, entire towns are moving to higher ground, seeking protection from the many cyclones that hit the islands. The fish in Malawi's Lake Chilwa have disappeared, due to drought.

There is little doubt that these and other changes are human induced.

The time to take action is now

Noting the profound consequences of climate change, the United Nations Environment Programme (UNEP) labels it one of the most critical challenges of our time. UNEP calls for a double strategy – to reduce greenhouse gas emissions and realistically assess the implications of the changes that are already upon us and adapt accordingly.

The World Bank has also sounded the alarm. It predicts that human-induced climate change will cause decreased agricultural activity, decreased water quality and increased incidence of diseases ranging from malaria to dengue fever.

Even worse, the Bank projects the possible displacement of tens of millions of people from low-lying areas from Beijing to Boston as water levels rise.

UNEP Executive Director Achim Steiner has said, "Failure to slow down global warming, and to adapt to its already apparent effects, will make dealing with all the other environment and development challenges that much harder."

Indeed, climate change considerations – including efforts to promote clean energy alternatives whenever possible – are now incorporated into all World Bank development operations.

Government agencies and non-governmental organizations cannot solve the problem alone. Philips is keenly aware of its responsibility to

help stabilize, or even to reverse, global climate change.

Energy efficiency is essential

We recognize that energy efficiency is one essential answer, and we have made a serious commitment to develop, promote and market more energy-efficient solutions. We continue to move forward, refusing to accept the common wisdom that the bill to change manufacturing technology, not to mention to alter popular products and promote new versions, will be too high.

Philips management has long been convinced that a "green" approach to business is not only essential in terms of the environment, but also will ultimately prove to be the cost-effective choice. In short, the company never believed in the myth that the environment and economic growth were mutually exclusive.

Increasingly, others agree. In fact, *The Stern Review on the Economics of Climate Change* made international headlines when it was published on October 30, 2006. Carried out by

Sir Nicholas Stern, Head of the UK Government Economic Service and former World Bank Chief Economist, the *Review* estimates that if we don't act, the overall costs will be equivalent to losing at least 5% of global gross domestic product (GDP) each year. Stern projects that if a wider range of risks and impacts is taken into account, the estimates of damage could rise to 20% of GDP or more.

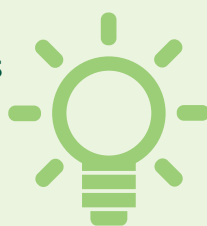
Act now, less cost

In contrast, the costs of action – reducing greenhouse gas emissions to avoid the worst impacts of climate change – can be limited to around 1% of global GDP each year.

Not addressing the issue of carbon emissions reduction, however, could result in an economy that shrinks by between 5% to 20% over the next two centuries – the result of continuous disruption to people's lives, according to Stern. He cites severe water shortages caused by melting glaciers as just one of many examples. And he warns that the time to take action is now, while the cost of change is still tolerable.

19%
of global electricity
is used for lighting

Philips is
the world's
leading
lighting
supplier



Leading change: Eliminating incandescent lighting

With its number-one position in global lighting, Philips recognizes the need to take the lead in changing the lighting industry.

One key element must shift, and soon, in order to increase energy efficiency. Inefficient and costly-to-operate incandescent lighting has to be eliminated.

At a December 2006 "Green" Conference in Brussels, Philips Lighting Chief Executive Officer Theo van Deursen announced that Philips would start this initiative in Europe, where the switch-over could happen within 10 years.

More than 2 billion inefficient, costly to operate incandescent bulbs are purchased every year in Europe alone. Up to three quarters of these are used in the home, the remainder being used in the commercial sector. The collective energy waste is dramatic. In fact, incandescent light bulbs are little more than heating devices, as 95% of the energy consumed is wasted as heat.

A better environmental choice

"A wide range of energy-saving light bulbs is available on the market today," Van Deursen says. "These not only save energy, but also cost far less to run and are simply a better environmental choice than incandescent light bulbs. We believe it is time to encourage the switch to energy-saving light bulbs by taking action to discuss the replacement of incandescent light bulbs."



"We believe it is time to encourage the switch to energy-saving light bulbs."

Theo van Deursen, CEO, Philips Lighting

So what's keeping people from making the change?

Incandescent bulbs are still top sellers, costing less than EUR 1 to buy. Yet an incandescent bulb uses up to EUR 15 worth of electricity per year, assuming a 100W light bulb consumes EUR 0.15 per kW/h and 1,000 hours use per year.

On the other hand, an energy-saving alternative bulb, although initially a bit higher in price, uses only EUR 3 worth of electricity, saving up to EUR 12 per year on an average energy bill. The consumer saves money and the environment benefits from lower energy consumption and indirect CO₂ reduction. Because many are unaware of these advantages, Philips is working to bring the message to people around the world.

A collective effort

There are also legislative and industry hurdles. "And it simply isn't realistic to ask manufacturers to make unilateral decisions to stop manufacturing incandescent bulbs," Van Deursen explains. "This needs to be done collectively and will probably need to be backed by legislation setting minimum performance criteria. Otherwise other manufacturers would simply move into the void and the problem would remain."

Philips does not expect this phase-out to happen overnight. "We will probably be talking several years before the industry could replace the incandescent bulbs by alternative solutions in the quantities needed," he concludes, "but we believe the process should start now."

Philips calls for joint action between the lighting industry, non-governmental organizations, energy suppliers and governments to replace the incandescent light bulb with the many energy-saving alternatives available today.

Smarter lighting

The façade of Buckingham Palace is now bathed in a soft wash of light in the evenings. The 45 Philips LEDline 2 modules that illuminate it project precisely controlled washes of light exactly where they are needed, so no overflow lighting enters the palace windows. Tourists love it.

There are environmental benefits, too. LEDs are extremely energy-efficient, with a lifetime of 50,000 hours. And the maintenance costs of the new lighting have also been significantly reduced.

In undertaking this project, Philips was careful to use lighting technology that could be totally controlled, thus avoiding light pollution.

We have long been active in getting anti-light pollution standards adopted in various European countries. Our efforts in this area extend to a life membership in the US-based International Dark Sky Association. In the Netherlands, we are active partners with the Society for Nature and Environment in project "Economy Light," which works toward reducing energy demand for public lighting, while striving to maintain safety.

We believe the solution to these concerns is to use "smarter" lighting, such as the emerging LED technology that now illuminates Buckingham Palace.

Making an impact: Global lighting by the numbers

- Lighting is responsible for 19% of the world's electricity consumption, according to the International Energy Agency.
- Energy efficient lighting technology developed over the last two decades offers significant savings in energy, expense and carbon dioxide emission.
- In the past five years, Philips has invested more than EUR 400 million in R&D, resulting in attractive new energy efficient lighting solutions.
- Despite these advances, between 67% and 75% of the world's lights utilize older, less energy efficient technology – some dating as far back as the 1950s.
- If new technologies were adopted, achieving a realistic energy saving of 20% throughout the world, the results would include a EUR 53 billion savings in energy costs. This equates to:
 - 296 million fewer tons of CO₂ emissions and more than 779 million fewer barrels of oil every year
 - The annual output of 265 medium-sized power stations
 - The entire surface area of Germany covered with a forest removing CO₂ from the air through photosynthesis.

Philips has the technology and the vision to achieve a reduction of at least 20%. In fact, we believe that additional savings up to 30% to 40% are feasible. Our goal now is to work in partnership with industry, governments and non-governmental organizations (NGOs) to break down the barriers – lack of awareness, financing and short-term thinking.

20%

less energy

If new technologies were adopted around the world, the results would include 296 million fewer tons of CO₂ emissions





Energy-saving alternatives

Eliminate incandescent bulbs? What will replace them?

We have worked hard to find answers, and there are a number of options available today, with more exciting possibilities looming on the horizon.

Compact fluorescents

When we invented energy saving compact fluorescent light bulbs in 1980, they worked well but were large and unattractive. Since then, dramatic improvements have been achieved in energy efficiency, switching speed and light quality.

Today's new generation of high-quality compact fluorescent lamps are far smaller, less expensive and offer a higher quality of light than the earlier generations.

Compact halogen bulbs

Our new revolutionary energy saving halogen bulbs for the home – called Ecore – offer clear crisp lighting and use 50% less energy than the ordinary household bulb it will no doubt replace. Available in the second half of 2007, the Ecore is a retrofit halogen bulb that can be used in a normal fitting.

LED technology

Light-emitting diode (LED) solutions are also available today that can alter home decor by offering a broad pallet of colors from which to choose. This lighting technology promises even greater energy savings in the future.

The downside – and at this time there still is one – is that, while LEDs use much less energy, they do not yet offer sufficient light output compared with incandescents.

Progress on this technology continues, however. The new “green” LEDs, which generate 100 lumens per watt, clearly show that light-efficient LED technology offers both the power and the eco-benefits that will one day make it the norm. We are also working toward ambient intelligence in LED lighting, with light levels adjusting according to available natural light, and even to where people are located in a room – significantly reducing energy use.

We are looking at new Organic LED (OLED) technology for general lighting applications, with long lifetime and high energy efficiency.

Capitalizing on LED design possibilities

We took a major step in 2006 with the acquisition of Partners in Lighting International (PLI), the Belgium-based European market leader in home luminaires (lighting fixtures), widely recognized for its design innovation.

“PLI has an impressive track record of entrepreneurship and design innovation. By teaming with it, Philips will be able to establish a strong position in the home lighting market,” says Theo van Deursen. “Their design expertise will work well with the inherent design possibilities in our growing LED business.”

We are exploring many exciting possibilities

Creating awareness around the world

Clearly, both the cost and quality-of-life benefits that result from upgrading to modern energy efficient lighting are enormous. But Philips faces the twin dilemmas of lack of awareness and short-term thinking.

That's why we expanded the awareness campaign we launched in Europe in October 2005 to the rest of the world in 2006, extending the scope from street lighting to also include lighting systems in offices and homes.

People tend to focus on the immediate issue of installation cost, overlooking the more relevant energy cost, which can amount to 90% of total lighting cost. Recent history shows that upgraded lighting systems can have a payback time of less than three years, after which significant energy and cost savings are achieved.

Better lighting, better learning

What sector is one of the largest users of lighting? Schools. After all, there are far more children sitting in classrooms than there are executives sitting behind desks.

people feel better working under higher quality lighting. This means better learning environments, greater levels of motivation and lower levels of absenteeism.

payback on new lighting systems is as little as three years.

Australia's energy-conscious kids

We believe children are an ideal audience for the message about saving energy and reducing greenhouse emissions. After all, it is their future that is at stake.

School budgets should go toward books – not to unnecessary electricity bills to run old, inefficient lighting.

Moreover, many of these children may be squinting, due the lower quality of light from costly, old 1950s lighting technology. Having difficulty making out the sentence or math problem or lab experiment directions clearly has a negative impact on learning.

Benefits of higher quality lighting

In fact, studies have shown that

Schools consistently battle the budget, and most would agree that the majority of funds should go toward books – not to unnecessary electricity bills. Installing modern lighting equipment not only has a powerful impact on learning, but also results in such significant savings on electric bills that there would still be budget money for books. And the

Primary school students in New South Wales, Australia, are learning all about saving energy because Philips is teaching them how to become "Planet Earth Power Kids."

This educational program is a partnership with the New South Wales' Government Greenhouse Gas Abatement Scheme, designed to help reduce greenhouse gas emissions. Youngsters learn the importance of taking shorter showers, turning off lights, and riding their bikes, rather than having their parents drive them from place to place.

They also receive energy saver light bulbs to take home. If they share the conservation lesson with their family, they receive a free six-pack of energy-savers, which use up to 80% less energy compared with standard incandescent bulbs.

And Philips is donating 25 energy saving Alto Florescent tubes to every participating school for use in the classroom.



Toward zero net energy buildings

- Buildings represent 40% of the world's energy demand. That is expected to grow 45% in the near future, with a 92% increase in carbon emissions. Philips and other leading global businesses are joining forces to tackle this issue,

participating in the World Business Council for Sustainable Development's Energy Efficiency in Buildings initiative.

- The goal: Buildings that consume zero net energy from external power supplies and produce zero net carbon dioxide

emissions while being economically viable to construct and operate, by 2050.

- At Philips we also are focused on what we can do today to accelerate the changeover to energy efficient lighting now and in the next few years.

How low is low enough?

The dilemma: That sleek flat screen TV you just bought. Nobody's watching it at the moment. In fact, it's on standby. Yet it is still drawing energy from the power grid while it waits for you to switch it on again.

Progress has been made in reducing this hidden energy use. That television that used 8 or 9 watts of electricity on standby a decade ago may be close to using only 1 watt today. In fact, as a result of discussions at the 2005 Gleneagles Summit, an "International 1 Watt Initiative" has been launched, under the auspices of the International Energy Agency. The goal: to reduce standby power to 1 watt or lower.

We are already ahead of that goal with our current televisions. And we aim to lower standby to below 0.2 watts in televisions we will introduce in 2008.

Having made such progress in this hidden, but vastly important, area of energy usage, a new dilemma arises.

When is low stand-by power low enough? Is it possible to reduce to

virtually zero watts? And if so, would the costs surrounding that outweigh the small additional benefits? The question ultimately becomes, "When is it time to stop?"

We believe that we have essentially met the standby challenge, but will continue to seek cost effective solutions. Given that standby electricity usage for television currently amounts to around 4% of total usage, we can have a more significant impact focusing on that other 96% of energy usage – the energy spent when the television is on. Here too, we are achieving success and additional reductions are in the pipeline. In particular, we are introducing energy-saving innovations in our LCD TVs, like automatic dimming backlights and ambient light sensors, which reduce brightness when people view TV in the evening.



Philips TVs win "green" awards

Philips 42-inch LCD-HDTV Pixel Plus HD 42PF9731D combines enhanced viewing experience through Ambilight Surround, and offers environmental benefits like 28% less energy consumption than competitor models and elimination of six hazardous substances. That's the determination of the judges who named it a "CES Innovations 2007 Eco-Design Honoree."

Honors also came to our 42PF7621D Flat TV. It was named EISA European Green TV of the Year for its extraordinarily low power consumption, 15% less than its nearest competitor:

These TVs are just two examples of the 57 Green Flagship products Philips introduced in 2006.

Good for the world, good for business

From office lighting to intelligent LED lighting, from energy-saving TVs to lamps with decorator appeal and the ability to halve energy consumption. These are just some of the new

solutions from Philips that respond to the challenge of climate change. We believe these innovations are a triple win: good for our customers, for the world and for business.





Healthcare solutions

Over the next 50 years, the rapidly growing world population will add significant stress to an already strained healthcare system.

Current projections show that the number of people on the planet – currently 6 billion – will reach more than

9 billion



From 2000 until 2050, the world's population aged 60 and over will more than triple from 600 million to 2 billion.

The largest share of that population growth will occur in developing and emerging economies, which have the weakest healthcare systems.



Making healthcare available and affordable

In Japan, doctor's waiting rooms are packed with elderly patients, seeking treatment for a range of chronic diseases.

Busy city hospitals in China struggle to find ways to get competent care to remote villages.

In the United States and Europe, patients are frequently treated at understaffed hospitals.

Our healthcare activities are inspired by the same vision: remove barriers to the best possible care

The market for healthcare is growing rapidly. The cost for that care is soaring. Delivery of care across world markets is widely out of balance... and even as global population numbers shoot higher, the number of healthcare workers available to treat that population continues to diminish.

These are some of the dilemmas facing the healthcare industry in the early years of the 21st century.

Solutions can be found. Philips is devoting significant research funds toward doing just that for all of the world's markets. What benefits high-income countries can also help developing nations as the type of issues faced by rich and poor countries is rapidly converging, with both facing an increasingly similar spread of diseases. The third world is catching up to the first in mortality rates from non-communicable illnesses usually associated with high-incomes. Cardiovascular disease, cancer and diabetes, among them.

"We want to help build a world where access to healthcare is universal; where a person can be healed before falling ill; where a patient can be 'seen' without leaving his home; where urgent medical decisions can be made instantly because relevant information is readily available," says Gerard Kleisterlee.

Disparities in care

It's a fact. Where you live on this planet has almost everything to do with the kind of care you will receive.

North and South America make up 14% of the world's population, have only 10% of the world's disease burden, have 42% of its healthcare workers and spend 50% of all global healthcare costs. By contrast, Sub-Saharan Africa has almost the same number of people, 11% of global population, carries 24% of the world's disease burden, is cared for by 3% of the world's health workers and spends 1% of global healthcare expenditures.

New portable technologies, distance technologies and imaging systems currently being developed by Philips will allow quality care to reach more corners of the world, helping to reduce these disparities in the years to come.

This enhanced care will, in turn, help these countries prosper, since, according to a major study done by the European Union, there is no stronger driver for economic growth than good healthcare.

A big part of our business

25%

Philips Medical Systems accounts for 25% of our total revenue.



70% of all healthcare costs are incurred in five countries: France, Germany, Italy, Japan and the United States.



The trends

If population growth is a severe challenge to healthcare providers, population maintenance – caring for the aging populations in Europe, the United States and Japan – is equally challenging. These elderly patients tend to seek care for more critical and chronic diseases, often ones that require costly, and emotionally challenging, institutional care.

In fact, healthcare costs tend to rise in lockstep with population age, grabbing an ever-growing share of developed nations' Gross Domestic Products (GDPs). Healthcare in Germany, for example, counts for about EUR 240 billion, or 11% of that country's GDP. Projections indicate that that number could leap to 22% by 2020.

The situation is even more extreme in the United States, where Americans spent a staggering 16% of GDP on healthcare in 2005.

Clearly, cost is a barrier to quality care, but it isn't the only one. The critical shortage of healthcare workers is another. Today, there are only 59.8 million healthcare workers – many of them approaching retirement age – available to care for a global population of 6 billion patients.

These statistics clearly show that dramatic shifts must be made in how we handle healthcare, at every stage of the care cycle.

Driving change

Technology will drive that shift, and Philips Medical Systems is at the forefront in this effort. Our targets range from new technology that can detect disease earlier, when it is less costly to treat and will produce better outcomes... to technology that will help chronic or elderly patients stay in their own homes longer... to new styles of treatment using miniscule sub-atomic particles.

Ultimately, our new innovations will not only improve outcomes, but also reduce labor needs and make quality diagnosis and treatment available to a greater number of the world's people, in all markets.

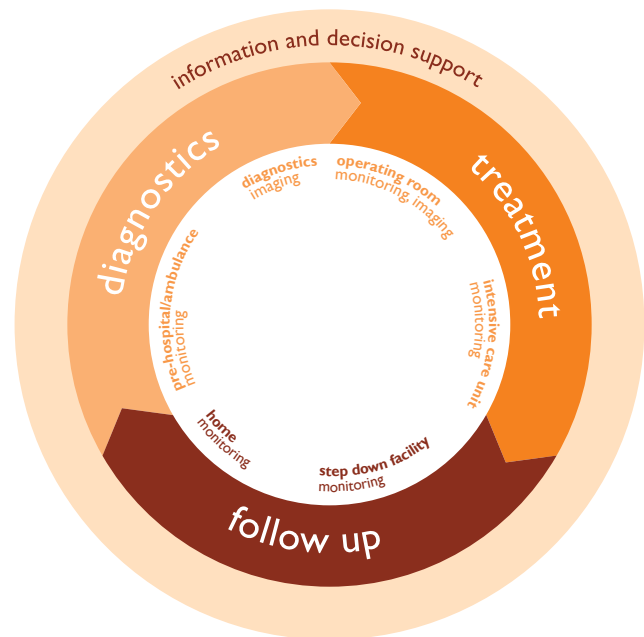
All of those goals, of course, are central to our overall mission – to improve people's quality of life. And we want to do so while reducing costs and increasing efficiency.

Seeking solutions for all markets

In developing countries, increasing access to healthcare is a dramatic challenge that needs urgent solutions. We simply need to make care available to a growing and increasingly demanding population. In the developed world, there is a rising demand

for better quality care that is affordable. Savvy patient-consumers want more personalized healthcare solutions and more emphasis on prevention and follow-up care. At the same time, we worry about rapidly rising costs.

Putting the patient first, throughout the care cycle



As Philips seeks ways to meet the rapidly growing demand for healthcare, we know that we can no longer focus on isolated aspects of care. We can't provide a state-of-the-art imaging solution for a patient and say, "There, the job is done."

Instead, we are now directing our attention toward patient-centered care. Rather than developing technological solutions for individual, discrete problems, we are targeting our R&D efforts toward finding solutions for patients at every stage of the care cycle. That cycle begins before a patient exhibits any symptoms and proceeds through diagnosis, in-hospital treatment, follow-up monitoring at a step-down facility and long-term monitoring at home.

Patient-centered approaches

Patient-centered care also refers to patient comfort. That can mean inventing imaging machines so small that they can go to the patient. It can mean developing technology that significantly reduces the time that complex medical tests can take. It can also refer to providing patient-friendly settings, such as our new Ambient Experience Catheterization Lab, designed to provide a comforting, calming setting for patients undergoing high-stress interventional procedures. This new lab – complete with personalized lighting, sounds and images – reduces the need for sedation, shortens the amount of time for the test and helps eliminate the need for repeat procedures.

Providing patient-centered solutions and cooperating with different players

– researchers, other manufacturers, healthcare workers – throughout the care cycle, are key priorities for Philips.

IT solutions

Through our Picture Archive and Communication Systems – PACS – healthcare partners, hospitals, off-site specialists and general practitioners are now able to share imaging data. Through new Philips inventions, we are able to diagnose problems much earlier in the care cycle. With our new solutions, elderly patients with chronic illness can be monitored in their own homes, using high technology systems.

We are helping clinicians manage healthcare issues from early diagnosis to end of treatment: through every stage in the care cycle.



To satisfy the new demands in healthcare, we must bring down the barriers that still separate the various parties in the care cycle. We have to integrate solutions across the cycle if we want to achieve higher quality healthcare at an affordable price.

Patient-centered care helps keep patients at home

Research consistently shows that elderly patients or those with chronic illness would much rather be at home than in an institutional setting. Home care is far less costly too, making it a win-win situation. Plus, the increasingly aging populations in many countries simply will not be able to be cared for in traditional institutional settings.

Philips has made patient-centered home healthcare – an important stage in the care cycle – a top priority.

Our MOTIVA technology, already in use in the Netherlands and the United States, monitors chronic cardiovascular conditions in patients' homes via interactive broadband communication channels. Patient tele-monitoring has a broader scope, monitoring asthma, diabetes, hypertension, heart and other chronic diseases via home measurement devices installed in television sets.

Philips also acquired Lifeline in 2006, a leader in personal emergency response services in the US. Lifeline has great global growth potential, as it meets patients' wishes to stay in their own homes, while providing the security of instant contact with help when needed.

Enabling early diagnosis with pre-symptomatic care

We have long known that early detection of heart disease, cancer or other major illnesses can improve outcomes.

Imagine what would happen if those diseases could be detected much earlier... before the patient feels a single chest pain or finds that first tiny lump.

Philips is focusing on developing technology that can enable diagnosis in the very earliest stage of the care cycle. After all, when disease is found before symptoms have even appeared, treatment can be far less invasive. That, in turn, results in a higher success rate, a faster return home, shorter after care and more positive long-term outcomes. It also means fewer costs over the life of the illness.



Early detection of lung cancer

Lung cancer is one area where we believe pre-symptomatic technology can make a powerful difference. The mortality rate from lung cancer is currently 95% if diagnosis happens in a late stage. Early diagnosis improves this dramatically. We believe that new technology that can detect lesions and nodules before symptoms occur can result in significantly better outcomes.

For patients receiving standard chest X-rays, our new Philips xLNA Enterprise 2.0 computer-aided detection (CAD) software has the potential to turn each X-ray into an effective warning system, with its ability to detect and show small lung nodules that previously did not appear on X-rays.

Our new breakthrough GEMINI TF PET/CT system, using new time-of-flight imaging, goes even farther, identifying cancerous or pre-cancerous lung lesions at extremely early stages.

We believe that both of these innovations, which were introduced at the 2006 annual meeting of the Radiological Society of North America, will result in such early detection of lung cancer that preventive treatment may work, significantly reducing lung cancer mortality in the years to come.

These new devices will also deliver cutting-edge images in areas ranging from cardiology to neurology.

The world's fastest growing disease...

isn't heart disease... isn't cancer... it is diabetes, which is swiftly reaching epidemic proportions. Globally, some 194 million people currently have diabetes, and that number is expected to climb to 333 million by 2025. There is no cure.

Philips Research is looking at how technology can be applied to make managing this disease easier, exploring promising non-invasive ways of detecting glucose in the blood. This would reduce pain and risk of infection, while increasing patient compliance, resulting in better health.

The future... personalized care

Philips Research is working on futuristic technology that can more finely target care to a specific patient's.

The emerging field of nanotechnology – basically involving research at the atomic and molecular level – holds great promise for both pre-emptive diagnosis and customized care.

At the C-TRAIN Research Center in St. Louis, Philips provides equipment and personnel, and collaborates with Washington University's researchers and doctors, on such efforts as using nanotechnology to bind cancer cells before tumors have a chance to form.

Ultimately, doctors will be able to use nanotechnology to determine on-the-spot whether a patient may be at short-term risk of a heart attack, using a method as simple as the one a diabetic uses to check insulin levels in blood.

Molecular medicine, offering insights into genetics and biochemistry, is also a rich ground for exploration. Philips researchers are focusing on sensitive detection in-vitro (test tube) of specific substances in patient material that may also indicate early disease. Molecular imaging, using specific contrast agents, can then support the in-vitro diagnosis.

For example, if the molecular test tube test reveals cancer, but the tumor is still too small to be seen by the naked eye, molecular imaging can often reveal it.

We are currently working with Schering on a molecular project focusing on very early breast cancer detection. As this technology matures, it will have powerful results: more accurate diagnosis, earlier diagnosis, minimally invasive surgery and significantly reduced cost of illness.



In the emerging field of nanotechnology, research is done on objects in the range of 1-100 nanometers, or about one millionth of a millimeter. For perspective: a human hair is 80,000 nanometers wide.

Finding plaque early may revolutionize cardiac care



Most people know that plaque builds up in arteries, causing heart attacks. What many people don't know is that half of all men and two-thirds of all women who suffer heart attacks never had a warning symptom. The plaque simply builds up, slowly and silently, until a piece breaks off or a clot lodges, partially blocking the artery, cutting off blood supply.

Why does this happen in some people and not others? Some people form "vulnerable plaque," which can rupture and cause an arterial occlusion. Such people are at high risk of heart attack or stroke. If these "high risk" patients could be identified, preventive care could be administered.

Given that heart attacks are the world's leading cause of death, major healthcare companies, including Humana, a provider of health plans; drug manufacturers Merck and AstraZeneca; BG Medicine, involved in genome research; leading physicians, Valentin Fuster, M.D., Ph.D., and Erling Falk, M.D., Ph.D.; and Philips, with its imaging machines, are all collaborating on a major study.

Working backwards in the care cycle, the research team seeks patterns by evaluating patients already known

to have at least two cardiac risk factors. Philips is developing the imaging procedures for some 4,000 to 6,000 computerized tomography X-ray scans of coronary arteries and ultrasound scans of necks (where plaque build-up can lead to stroke). In addition, a smaller sub-group will be given PET scans, so that inflammation can be examined in greater detail.

The ability to perform preventive care on people at risk for heart attacks could save many thousands of lives, as well as many thousands of dollars.

It could, in fact, revolutionize cardiac care. As *The New York Times* put it, "the dream is of a day when doctors will prevent heart attacks the way dentists can help prevent tooth decay, with a mix of devices and drugs."

Our ultimate goal is to provide patients with access to affordable and available high quality healthcare, all over the world. After all, healthcare is about improving people's lives at the most basic and important level. At the same time, healthcare promises to be a tremendous engine for economic growth. It's all about delivering value.



Supporting development

4 billion people in the world
earn less than USD1,500 a year

The United Nations
says we are the first
generation that can
eradicate poverty



“It is the absence of broad-based business activity, not its presence, that condemns much of humanity to suffering. Indeed, what is utopian is the notion that poverty can be overcome without the active engagement of business.”

Former UN Secretary-General Kofi Annan

Innovation for development

World leaders from rich and poor countries alike, representing all United Nations Member States, have pledged to achieve the eight Millennium Development Goals (MDGs) by the year 2015. They are committed to significantly reduce poverty, illiteracy, inequity and disease in poor countries. Realizing the MDGs will mean significantly improved lives for the 4 billion people who have insufficient access to affordable goods and services.

“For decades the world has tried to eradicate poverty. Doing this through charity alone simply has not worked,” says Gerard Kleisterlee. “Society is increasingly expecting that industry play a role. It’s time to take a more business-like approach, one where there is a clear win-win: value creation for communities and corporations.”

We know that this requires customized business models to meet the needs of the billions of low-income people in developing and emerging countries. “Industry, government, non-governmental organizations need to work together, leveraging the competencies each brings to the table. Most importantly, this should include local production, local talent development and local entrepreneurship,” Kleisterlee explains.

Beyond business as usual

Our experience has shown that innovation is essential. Reaching these markets requires tailor-made solutions for local markets, a different approach to marketing and distribution, and appropriate education for end-users.

It also involves long-term commitment and investments, along with new ways of measuring success. Another critical factor is the need for creative partnerships and business models with NGOs, social enterprises, donors, microfinance institutions and local governments.

At Philips we firmly believe sustainability offers a world of opportunities to improve quality of life and create value. Taking into account the MDGs that relate to our company’s know-how and capabilities, our greatest asset as a partner for development lies in leveraging our innovations to improve the lives of those living at the base of the

economic pyramid, focusing on health and energy.

We’ve highlighted some of the ways we are doing just that in the following pages. These projects are dedicated to improving livelihoods, increasing access to healthcare and combating diseases of poverty. MDG icons are included to offer insight into the impacts we aim to achieve with our initiatives.

It’s all about supporting development through innovative solutions, business models and multi-sector partnerships. It’s beyond business as usual.

“Our world is characterized by a clear divide between those who have access to a decent income, affordable healthcare, education and the fruits of the digital revolution, and those who have not. They should become ‘haves’ as well, enjoying the fruits of our technological progress.”

The UN Millennium Development Goals



Eradicate extreme poverty and hunger



Achieve universal primary education



Promote gender equality and empower women



Reduce child mortality



Improve maternal health



Combat HIV/AIDS, malaria and other diseases



Ensure environmental sustainability



Develop a global partnership for development

Improving livelihoods

Simple, cost effective lighting is a basic need for the 1.6 billion people who lack access to electricity. Even when people do have access to electricity, the power supply is often not constant or is only available for a few hours per day, especially in rural areas.

Fuel-based lighting is therefore widely used by households in developing countries, accounting up to one-third of household income, according to the International Finance Corporation (IFC). These households currently spend EUR 38 billion a year – or 17% of the total global lighting market.

Yet this high cost yields a low return. Fuel-based lighting's poor quality makes it difficult to work or study in the evenings. Further, indoor pollution from conventional sources of light, like kerosene, causes respiratory problems and is a source of greenhouse gas emissions.

The IFC explains: "Modern lighting technologies have lower ownership costs than fuel-based lighting, do not generate indoor pollution and can support small scale income generating activities – fostering a virtuous cycle of development and poverty reduction."

A reason to smile



We want to provide affordable, high-quality, energy-efficient lighting where it is most needed. Our SMILE (Sustainable Model in Lighting Everywhere) project is doing just that.



We kicked off this initiative in late 2004 with extensive community research in India. Based on feedback, we developed and sourced two lighting solutions that are the heart of SMILE: UDAY, a rechargeable portable lantern, and KIRAN, a hand-cranked LED flashlight.

In 2006 we launched a commercial pilot in four Indian states to further test the product specifications and establish business models.

Collaborating with local community organizations has proven essential to understand these markets. For this pilot we partnered with Development

Alternatives, Development of Humane Action Foundation and MART Rural Solutions. They have expertise in developing independent entrepreneurs and in community-based marketing.

Progress so far shows that modern lighting has significant potential to improve people's livelihoods. Shops, kiosks and street vendors are lighting their merchandise with UDAY. Children and adults study in the evening without eyestrain. Fishermen, who often work in the middle of the night, use the products on their boats, while farmers use them in the fields before sunrise. And families light their homes without creating indoor air pollution or risking fire.

We plan to expand SMILE into eight other Indian states, strengthening our cross-sector partnership approach



to build new sales channels and design additional lighting solutions.

Philips also will participate in the IFC's "Lighting the Bottom of the Pyramid" project. This four-year initiative aims to bring modern lighting to underserved parts of the population in Kenya and Ghana by developing the local LED market.

1.6 billion people lack access to electricity



Making healthcare available

At Philips we believe that access to quality healthcare should be a right – not a privilege – for all people.

Every day patients in developing countries go untreated or receive treatment too late because medical care is not within their reach. They have no access to ultrasound, X-ray and other essential technologies necessary to prevent, diagnose and treat illness. In fact, it is estimated that three-quarters of the world's population lacks

access to diagnostic imaging services. It simply doesn't exist.

Or if it does there's no electricity to power equipment or provide lighting. Even if those barriers were not in the way, the fact would remain that the developing world faces severe shortages of skilled health workers.

We are committed to making total healthcare solutions available to people who are not currently served.

Working with an NGO as a customer



Rheumatic heart disease – the result of untreated strep throat – was common prior to antibiotics. Today 80% of rheumatic heart disease cases occur in developing countries. When care is finally sought, the required treatment can be far more extensive, including surgery or cardiac catheterization. This is out of reach for many families in Kenya.

The Mater Hospital, a non-profit trust in Nairobi, provides affordable, high quality medical care and is one of the few hospitals in East Africa with a comprehensive cardiology program. The NGO Terre des Hommes, a child rights organization that helps organizations in developing countries, has supported Mater's cardiac program since 2001.

The hospital's cardiac clinic boasts a skilled team and modern facilities, including a Philips Integris CV series catheterization lab financed by Terre des Hommes. Philips ensured the lab was properly installed and provided advice on infrastructure requirements, as



© Sven Torfinn

well as an extended warranty, including maintenance, staff re-training and parts replacement if necessary.

"Thanks to its state-of-the-art facilities, Mater's cardiology program is increasingly being recognized as a regional center of excellence," says Ron van Huizen, from Terre des Hommes.

"This creates an upward spiral. As more and more patients are referred to Mater, the doctors hone their skills, the hospital's reputation gets even better, staff stays on board, costs go down and, most importantly, care is available for those most in need," he explains.



© George Moller

An estimated 2.4 million children in developing countries suffer from rheumatic heart disease

12 out of every 1,000 children in Kenya are born with congenital heart disease.



Taking a holistic approach



What makes a donor-financed healthcare project successful? We believe the project must fulfill an urgent need and be built on existing infrastructures with local people, making it sustainable.



In collaboration with our partners, we have developed a model for turnkey healthcare projects that do just that, making them eligible for grants from the Dutch government's Development-Related Export Transactions Program (ORET) and other donor programs. Such initiatives reduce the costs to developing countries by awarding them grants to acquire capital goods, technical assistance and service.



What makes this work successful is holistic project design and implementation that takes the bigger picture into consideration. It's not enough to simply supply and install equipment. Comprehensive project management is essential – from evaluating the infrastructure to training and maintenance – to support local clients and enable them to continue after we have left. The work often includes rehabilitating the facility, ensuring clean water and energy supplies, and providing assistance related to waste management and patient flow.

Beginning with a project in Zimbabwe in 1993, we have worked on ORET and other aid projects since then, representing a turnover of more than EUR 250 million.

We have implemented large-scale healthcare projects in Ghana, India, Indonesia, Jordan, Kenya, Morocco, Tanzania and Uganda, and are currently working in Bangladesh, China, the Philippines and Zambia.

Starting with a needs assessment and feasibility study, these projects can take as long as 10 years. To ensure proper implementation, we frequently establish local offices and select partners to handle construction, distribution and logistics. Human resource development and retention is a critical success factor, so we ensure training of healthcare and maintenance staffs, enabling them to properly install, use and service the new systems including X-ray, ultrasound and surgical equipment.

Tanzania project results

- 98 hospitals and clinics nationwide
- 106 X-ray units installed
- 6 radiologists and 91 radiographers trained
- 92 ultrasound units installed
- 197 ultrasound users trained
- 90% uptime of installed equipment
- 85% retention of trained staff
- 31 power generators and protectors installed



Up to 50% of medical equipment is not in use in developing countries

It may not be maintained or health personnel may not know how to use it. Consider the implications for healthcare delivery and this waste of scarce resources.

Combating diseases of poverty

While diseases often associated with high-income countries, including diabetes, cancers and cardiovascular diseases are on the rise in developing countries, the World Health Organization (WHO) estimates that diseases associated with poverty account for 45% of the disease burden in the poorest parts of the world.

Polluted water, inadequate living conditions, poor nutrition and the lack of health education lead to preventable illnesses like diarrhea,

respiratory infections, malaria and tuberculosis. At the same time, sickness affects people's productivity or prevents them from working, reducing their family income and continuing the cycle of poverty.

At Philips we are taking steps forward with products designed to combat diseases caused by indoor air pollution and unsafe water.

Cooking up a sustainable solution



Every day millions prepare their meals on traditional wood-burning stoves, filling their homes with indoor air pollution. WHO notes that this "killer in the kitchen" is one of the top-10 global health risks. Women and small children, who traditionally do the cooking, breathe in the equivalent of two packs of cigarettes a day, suffer from stinging eyes and have difficulty breathing due to chronic respiratory disease.

The Philips Woodstove – a smokeless, fuel-efficient stove – can change all that. The stove's innovative fan generates a clean burn, dramatically reducing smoke emissions. Compared with traditional stoves, our stove uses significantly less wood, enabling households to save on fuel costs and also lessening deforestation.

After initial testing among 24 families in India, we launched a commercial pilot in 2006 in Maharashtra, Tamil Nadu and Uttar Pradesh, which will conclude in February 2007. So far, nearly 450 rural families have purchased the Philips Woodstove, which is locally produced. In addition to improved health, village women appreciate the time they save with the stove – starting a fire, cooking food and heating water is much faster. Plus, ashes don't accumulate on the floor.



As part of our distribution strategy, we are developing micro-entrepreneurs in partnership with two local NGOs active in the advancement of Self-Help Groups. Often consisting of women, these groups provide financing to their members from collective savings, enabling them to undertake entrepreneurial activities.

Knowing this product can benefit people in other parts of the world, we are investigating opportunities in Africa, China and Latin America.

Indoor air pollution kills more than 1.6 million people a year, accounting for 2.7% of the global burden of disease





Providing safer drinking water



The water sources used by many people in developing countries are



often contaminated with disease-



causing bacteria, leading to waterborne diseases like diarrhea and cholera.



This is why we are piloting the Philips Household and Community Water purifiers. They have the potential to give people access to safer water, by either purifying it in their own home or in their village. Using filters, the purifiers would remove bacteria, organic chemicals, mud and sediments providing families with clear, odorless, clean and tasty drinking water. Based on user-feedback from our pilot running in India, we are exploring how to improve the robustness and ease-of-use of these products.

Improving diagnostics



Malaria is both preventable and curable, yet a child dies of the disease every 30 seconds.



turn, the parasite develops drug resistance, rendering current treatments ineffective. This requires R&D for new medicines, raising patient costs.

Current diagnosis of this parasitic disease, carried from person to person by mosquito, is challenging. Healthcare workers may lack sufficient training. Or they may work in poorly lit areas, straining to look through a microscope at a parasite that's hard even for a trained eye to detect.

Philips Research is working to develop an effective, low-cost solution that would allow for faster diagnosis. This tool would be small, rechargeable and easy to use, bringing professional microscopy to any setting. Aided by the diagnostics' innovative software, health workers will be able to provide consistently high-quality diagnoses enabling the appropriate drugs to be given to those who really need it.

After symptoms appear, malaria can become life threatening in mere hours. Diagnostic procedures are unavailable or take so long that medication is often given without proper diagnosis. In

Distance healthcare

Through our DISHA pilot in India, which ended in 2006, we explored business models to bring healthcare to rural areas. We learned that mobile clinics need an easy-to-modify and flexible design, and partnerships need to be clear and aligned. This experience will be used in future mobile healthcare activities. One of our partners will continue to use the current DISHA van.

More than 1 billion people – 20% of the world's population – have no access to safe drinking water

Each year, 2.2 million people, mostly children, die from such waterborne diseases as diarrhea and cholera

There are at least 300 million acute cases of malaria each year globally

resulting in more than 1 million deaths – most of them young children living in Africa

The Philips Way



Philips has been improving the quality of life with pioneering innovations for over 115 years, ever since the company was founded as a manufacturer of lamps in 1891. We have simplified and enriched people's lives with key advances in the fields of medical imaging, television, lighting, optical technology and integrated circuits, to name but a few.

To remain viable and competitive, however, every company must embrace change. So, while celebrating our rich heritage, we have in recent years been engaged in a process of fundamental transformation – one designed to turn Philips into a market-driven company capable of delivering sustained profitable growth, thereby creating value for our stakeholders.

2006 saw a major step on this journey of change with the divestment of a majority stake in our Semiconductors division. This move was driven by the firm belief that it represented the best course of action for both Philips and Semiconductors/NXP. Philips no longer needs to own a semiconductor manufacturer to have access to state-of-the-art semiconductor solutions, while the transfer gives NXP the increased flexibility it requires to invest, grow and build scale in the highly competitive semiconductor market.

The way forward

Today, Philips is a much simpler company focused on the market, centered around the brand and driven by innovation. The emergence of the experience economy is creating a new market space with considerable growth potential for Philips. It is one in which we can leverage our competencies in design, technology and branding to capture value from some of the major economic, social and demographic trends, e.g. the growing demand for healthcare, the desire for a greater sense of well-being – in the broadest sense of the word – and the need for energy efficiency.

Our mission remains to improve the quality of people's lives through the timely introduction of meaningful innovations

Our mission remains to improve the quality of people's lives through the timely introduction of meaningful innovations. In an increasingly complex world, we strive to bring the power of human insight and experience to technology. We believe that technology should enable people to live life to the full. Applying our deep understanding of people's needs and desires and delivering on our promise of simplicity, we empower our customers with solutions that are advanced, yet designed around them and easy to experience.

Our solutions promote health and well-being and enhance the spaces in which people live, work and play, e.g. by offering them improved diagnostic experiences or greater control over their surroundings. Increasingly, these solutions are intelligent (sensing, learning and adapting), connected and easy to interact with.

Based on insights into what consumers really need and want, and supported by advances in miniaturization and interaction design, our focus is gradually evolving towards embedded functionality as an enabler of experiences. In this way, we can help create appealing ambiances and experiences in the home, offices, hotels, public spaces, sports venues, etc., making life simpler, more enjoyable and more productive.

Our enablers

Our brand promise

Our "sense and simplicity" brand promise guides us in everything we do. It expresses a commitment to put people at the center of our thinking, to eliminate unnecessary complexity, and to emphasize the meaningful benefits of technology. It also expresses how we want to be perceived by all our stakeholders: open and transparent, approachable, easy to do business with.

Our adoption of the Net Promoter Score (NPS), which measures people's willingness to recommend a company/product to a friend or colleague, will tell us just how well we are progressing in this regard.

Our mindset and way of working – One Philips

The concept of One Philips is central to becoming a focused, market-driven company that can deliver sustained profitable growth. One Philips is all about unlocking synergies by leveraging competencies and resources across the company. It expresses the belief that by working together we can create more value than the sum of the parts and achieve further growth at the points where our application domains converge.

Our talent

Ultimately, the quality of our people will determine whether we fulfill our mission and deliver on our promises to our external stakeholders. Accordingly, we are strengthening our talent management in order to secure the quality of leadership required to take our company forward – leaders who pursue market insight, create innovative strategies, inspire commitment, leverage capabilities, champion people's growth and drive for results.

Leadership is very much about securing employee engagement. This requires the creation of a diverse and inclusive working environment, where all employees are aligned and energized to contribute. We will be driving this forward on various fronts.

Innovation

We leverage our multi-disciplinary research and development capabilities to create new technologies and sustain our strong intellectual property position. And we are maintaining our investment in technology leadership, e.g. at our Incubators, which act as seedbeds for the transformation of promising innovations into winning business propositions.

Design

We continue to enrich our design process by integrating established design skills with input from other disciplines such as the human sciences, technology and business – and always with a clear people focus. It is our intention to design solutions based on in-depth user research, which harness technology to improve the quality of people's lives.

Sustainability

Social and environmental performance is a driver for innovation and value propositions, helping to keep our business sustainable in both the short and long term.

We do this with a sharp focus on energy efficiency and affordable and accessible healthcare in all markets. This also extends to pioneering ways of doing business, whether forging partnerships or developing new business models for new and emerging markets.

Our company strategy

We have defined six strategic drivers to enable us to attain our goals:

- Increase profitability through re-allocation of resources towards opportunities offering more consistent and higher returns.
- Leverage the Philips brand and our core competencies in healthcare, lifestyle and technology to grow in selected categories and geographies.
- Build partnerships with key customers and suppliers, both in the business-to-business and business-to-consumer areas.
- Continue to invest in maintaining world-class innovation and leverage our strong intellectual property position.
- Strengthen our leadership competencies.
- Drive productivity through business transformation and operational excellence.

Our sustainability vision

We want to become the recognized leader in key global market opportunities relevant to society at large, by applying our company strengths.

This means we will deliver value to our stakeholders by:

- Achieving a top ranking in the Dow Jones Sustainability Index and other ratings for investors.
- Offering a portfolio of sustainable products and services for our customers and consumers.
- Being perceived as a sustainable employer of choice for employees.
- Engaging in stakeholder dialogue on social and environmental issues.
- Creating economic value for shareholders.

“Sustainability, our world of opportunities”

Barbara Kux

Member Group Management Committee, Chief Procurement Officer and Chair Sustainability Board

A new world

The 21st century has distinct characteristics that will shape the world in years to come: We see global fragility as the world's population rapidly increases. Economic growth is shifting from west to east. There's an insatiable demand for fresh and differentiated products, while the potential for technical differentiation is decreasing. Information technology continues to expand, as does the power of ideas. Value chains are disintegrating and providing services is becoming more attractive.

On top of that, the overarching need for sustainable development challenges us to provide solutions to reduce our ecological footprint and enhance social equity.

Clearly, this has implications for corporate strategy and management, where a paradigm shift is underway. Being lean and mean remains essential, but this internal exercise must be accomplished by also looking outside the company. Achieving number one or two in your market is not enough. Finding a niche and creating something new has become equally important. And rather than looking only for “A” players, it's also critical to hire passionate people and focus on engaging them.

For corporations like Philips it is necessary to develop and implement a clear and simple vision. We've done

that with our sharpened market focus and “sense and simplicity” brand promise.

Our focus

With the pressing need to address both global warming and accessible and affordable healthcare in all of the world's markets, we have chosen to sharpen our focus on energy efficiency and health solutions. We believe our competencies in these areas can make a contribution to meeting these challenges. We want to build on our company mission to improve the quality of people's lives through the timely introduction of meaningful innovations.

Highlights of our results

Thanks to great Philips teamwork around the globe, and driven by our Sustainability Management Agenda and Key Performance Indicators, we made good progress in 2006. One key milestone is our improved performance in the Dow Jones Sustainability Index where we increased our score substantially and regained our position as sector leader.

We introduced 57 Green Flagship products on the market in 2006, bringing the total above 200. Sales of Green Flagships is now at EUR 2.2 billion and has become an important part of our revenue stream.

2006 also marked the third year of our ambitious and comprehensive



change program in supply management. We continued to strengthen supplier sustainability governance, and endorsed the Electronic Industry Code of Conduct. We started to outsource our sustainability audit activities in the supply chain and completed 365 audits.

Looking ahead

We have changed the composition of our Sustainability Board, which now includes management team members of all divisions to enable us to more fully explore business opportunities that can deliver value to individuals, communities and the company. With an eye toward continued future progress, we have established our 2007 management agenda and Key Performance Indicator targets.

Our goal is to further tap into the world of opportunities offered by sustainability as we continue on our path to sustainable development.

Making progress

2006 results: sustainability management agenda

To support our goals, the Philips 2006 sustainability management agenda focused on the following four areas:

1. Achieving our Key Performance Indicator (KPI) targets.
2. Leveraging sustainability as a business opportunity.
3. Launching our latest four-year environmental action program, EcoVision III.
4. Furthering the roll out of the Philips Supplier Sustainability Program to our supply base.

1 Achieving our KPI targets

To track our progress on the major issues regarding sustainability, we continued to track our progress on the Key Performance Indicators below. You will find details on our performance throughout this report.

2 Sustainability as a business opportunity

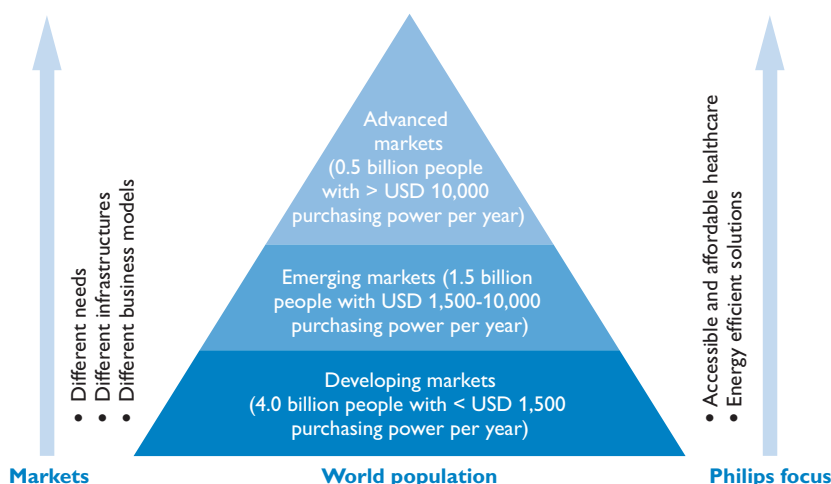
We have conducted market research to determine whether sustainability is relevant to our consumers in advanced markets. And if so, in what way is it important to them? To find out, we held group discussions and online interviews with consumers in Germany, the UK and the United States.

Key Performance Indicators 2005-2006*

		2005 Actual	2006 Objective	2006 Actual
Business				
Sustainable business	Percentage of sales from sustainable business (Green Flagships products)	—	3	8
	Number of new Green Flagships	46	35	57
New Sustainable Business Initiative	2006: Successful results of running projects	—	2	2
	Number of people that benefit from projects	20,000	50,000	N.A.**
Communication				
Stakeholder dialogue	Quarterly issue-grid reporting (from Q2 onwards)	—	Start Q2	Realized
Internal communication	Sustainability messaging measured among employees (%)	62 ¹⁾	70	70 ¹⁾
External communication	Number of favorable clippings in top level printed media	322	> 322	453
Social				
Health and safety	Level of absenteeism (%)	2.1	2.0	2.2
	Number of Lost Workday injury Cases/1,000 FTE	8.0	8.2	8.0
Diversity and inclusion	Women at executive level (%)	5	6	6
	Executives (%) from Asia Pacific	7	9	7
	Inclusion Index (% favorable)	55 ¹⁾	> 54	60
Human Capital	Employee Engagement Index (% favorable)	59 ¹⁾	> 58	61
Reporting				
Compliance	Reporting of alleged violations + number of corrective actions in SAR 2005	—	Feb. 2005	Feb. 2006
Supplier management	2006: on-site assessments of risk suppliers (%)	—	20	98
Performance	Quarterly results reporting on KPIs	—	Start Q2	Realized
Verification	Level of assurance	Moderate	Moderate	Moderate

* all data excluding Semiconductors ** data not yet available ¹⁾ including Semiconductors

Sustainability is a business opportunity in all markets



Consumers in these countries are most worried about the depletion of natural resources, pollution and energy issues. US consumers are less worried about climate change and greenhouse gases than consumers in the United Kingdom or Germany. We are also proud to say that the Philips brand is perceived as a credible brand for “sustainable” products, according to the study, supporting our “sense and simplicity” brand promise.

Acting on global concerns around climate change and rising energy costs, we have been working to raise awareness of the benefits of energy efficient lighting solutions. In fact, we have called for the elimination of inefficient, costly-to-operate incandescent lighting (see page 15).

This underscores our longstanding approach to EcoDesign, introduced in 1994, as well as our focus on developing Green Flagship products. In 2006 we launched 57 Green Flagships, up from 46 in 2005 (see page 72).

Turning to developing markets, we are making particularly interesting progress with two commercial pilots: the Philips Woodstove and SMILE (Sustainable Model in Lighting Everywhere) (see pages 31 and 34).

3 EcoVision III program

To sustain our leading position in the environmental area, we launched EcoVision III, which runs from 2006 to year-end 2009. Details on our progress can be found on page 55.

4 Sustainability in the supply chain

We have been working to further strengthen our supplier sustainability program and continue embedding sustainability throughout the supply chain. Our efforts in 2006 included a move toward standardization with our endorsement of the Electronic Industry Code of Conduct (see page 63).

Sustainability governance

We changed the composition of the Philips Sustainability Board to establish a membership that reflects our focus on sustainability as a business opportunity and supports our approach to embedding sustainability in the organization. The Sustainability Board includes a Management Team member from each of our divisions, Research, HRM and Legal. This group will meet four times a year, and one of those meetings will include our Extended Board members (the heads of a number of relevant countries/clusters).

Embedding sustainability at Philips

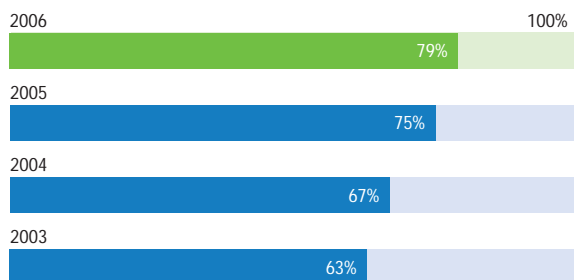
To achieve our goals, it is essential that sustainability be embedded in all of our everyday activities. To do this, we use an embedded model approach. In 2006 we extended our efforts on additional key functions, including Global Marketing Management, Strategy and our new business development Incubators.

One example is the sustainability strategy workshop hosted by Philips Research at the end of 2006. Participants from Research, the divisions and various functions met for three days to share ideas with one another and outside experts. They explored our focus areas of energy and healthcare, looking at business opportunities in all markets. Learning and education in developing countries was another key topic. Information from the workshop is available to employees via our intranet.

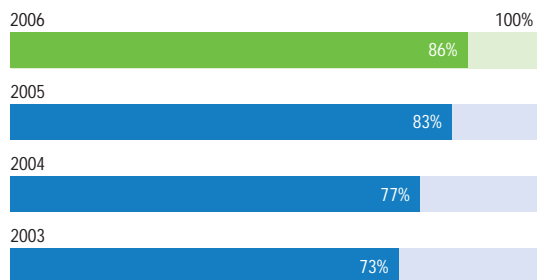
Engaging with stakeholders

To strengthen stakeholder dialogue, we have established a disciplined process to identify issues. Our businesses, regions and key countries identify issues with local management. Issue grids then are provided to corporate twice a year, allowing us to determine common issues, as well as challenges and opportunities. As necessary, issues are fed back to the appropriate product division for action. Going forward issue grids will be prepared

Philips' Dow Jones Sustainability Index scores Economic dimension



Philips' Dow Jones Sustainability Index scores Environmental dimension



by the four divisions, major business support activities (Research, Design and Intellectual Property & Standards), and 18 clusters in key countries, reflecting how our company is organized.

In 2007 we plan to work on stakeholder mapping to further expand our interaction with key groups. We also will explore ways to enhance two-way communications. During 2006 we laid the foundation, with such initiatives as an outreach program on healthcare in Japan and a multi-stakeholder event on energy efficiency in December (see page 15).

Recognition

Dow Jones Sustainability Index

We improved our performance in the Dow Jones Sustainability Index and regained our position as leader in the sector leisure goods. Scoring 82 points out of 100, compared to 77 points in 2005, we realized improvements in all three areas: social (5 points), economic (4 points) and environmental (3 points).



Global 100

For the second year running, Philips ranked among the Global 100 Most Sustainable Corporations in the World, announced at the World Economic Forum in Davos, Switzerland, in January 2006. The Global 100, which premiered in 2005, is a listing of the 100 large blue chip companies around the world that demonstrated the strongest sustainability performance among their peers.

Amsterdam Stock Exchange (AEX)

Philips continues to be included among top-performing sustainability companies on the AEX.

FTSE4Good

We are proud to continue to be included in the FTSE4Good Index Series, designed to measure the performance of companies that meet globally recognized corporate responsibility standards and facilitate investment in those companies.

Tomorrow's Value

Philips was once again included among the "Leading 50" companies in the biannual benchmarking survey of leading practice in corporate sustainability reporting, published by SustainAbility in partnership with the United Nations Environment Programme (UNEP) and Standard and Poor's. Entitled *Tomorrow's Value*, the survey ranks the world's leaders in corporate sustainability reporting, transparency and disclosure. Philips ranked number 12 in the survey, up from 39 in 2004.

Global Compact

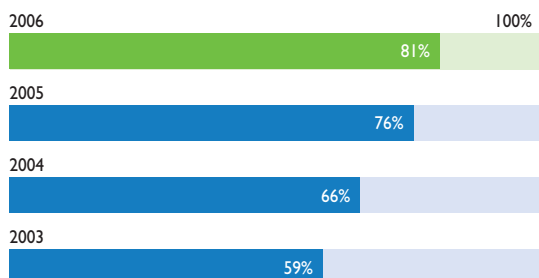
Philips has signed on to the United Nations Global Compact. According to the UN: "Today, thousands of companies from all regions of the world, international labor and civil society organizations are engaged in the Global Compact, working to advance 10 universal principles in the areas of human rights, labor, the environment and anti-corruption.

"Through the power of collective action, the Global Compact seeks to promote responsible corporate citizenship so that business can be part of the solution to the challenges of globalization. In this way, the private sector – in partnership with other social actors – can help realize the Secretary-General's vision: a more sustainable and inclusive global economy."

Our General Business Principles, Sustainability and Environmental Policies, and our Supplier Sustainability Declaration are the cornerstones that will enable us to live up to the standards set by the Global Compact.

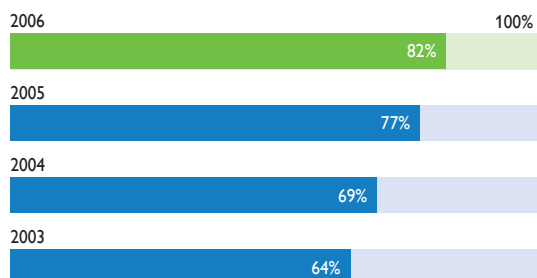
Philips' Dow Jones Sustainability Index scores

Social dimension



Philips' Dow Jones Sustainability Index scores

Total Score



Millennium Development Goals

Philips and five other multinationals (Akzo Nobel, ABN AMRO, BHP Billiton, Heineken and TNT) were asked to participate in a work-in-progress framework to measure corporations' contributions to the United Nations Millennium Development Goals. This framework was developed by an organization called Dutch Sustainability Research at the request of the Dutch National Committee for International Cooperation and Sustainable Development.

Moving ahead in 2007

To ensure that we continue to drive progress we have established an ambitious sustainability management agenda for 2007, along with a set of KPIs to drive our performance.

Sustainability management agenda 2007

In 2007 we will work to:

- Increase our performance in the Dow Jones Sustainability Index equal to the 2006 improvement.
- Further develop and build on our EcoVision program and Green Flagship products, including marketing and communication.
- Refocus our social investment activities.
- Carry out audits for all sustainability risk suppliers.

Our employees



The wide world of Philips

More than 120,000 Philips people in approximately 150 countries work together to create and sell new products and technologies. They brainstorm, research and develop. They build, market and service. In short, we touch people's lives every day.

Our employees

The number of Philips employees at year-end 2006 totaled 121,732. Compared with the year before, our total workforce decreased by 37,494 on balance. This is predominantly related to "discontinued operations," consisting of the deconsolidation of the Semiconductors division on September 29, 2006, and Mobile Display Systems. In addition, other deconsolidations led to a reduction of 7,622 employees. These reductions were partly offset by new acquisitions, resulting in an increase of 4,834. The most important of these were Lifeline Systems and Intermagnetics, both in the US.

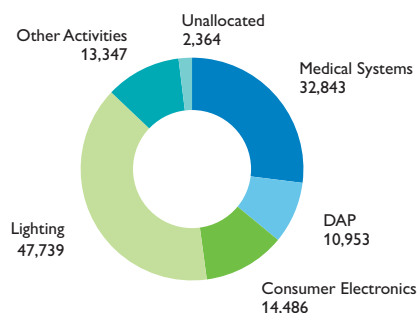
Excluding the changes related to the composition of the Philips group, the number of employees increased by 1,757, expressed in full-time equivalents (FTEs).

The main employee increase in 2006 was in DAP (due to the acquisition of Lifeline and Avent), Lighting (due to the inclusion of Feixin and bodine) and Medical Systems

Highlights

- Global implementation of the One Philips Ethics Line completed
- One Philips approach to the engagement process includes streamlined Engagement Survey
- Diversity and inclusion being embedded into existing processes
- Global Learning Portal launched

Employees by sector at year-end 2006
in FTEs



(due to the acquisition of Witt and Intermagnetics). The largest reduction in 2006 occurred in Other Activities (due to divestments and sales of businesses under Corporate Investments).

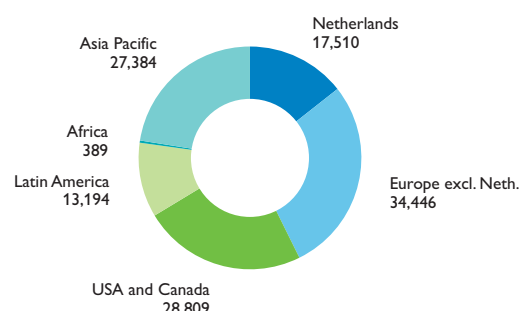
Excluding discontinued operations, the total workforce decreased particularly in Europe, by nearly 3,000, while the US saw an increase of about 3,500.

Philips General Business Principles

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

The GBP has been translated into most of the local languages and is an integral part of the labor contracts in virtually all countries where Philips has business activities. Responsibility for compliance with the principles rests principally with the management of each business. Every country organization and each main production site has a Compliance Officer. Confirmation of compliance with the GBP is an integral part of the Annual Statement on

Employees by geographic area at year-end 2006
in FTEs



Business Controls that has to be issued by the management of each organizational unit. The GBP incorporates a whistleblower policy, standardized complaint reporting and a formal escalation procedure. In 2006 the definition of human resource related violations was tightened to ensure complete consistency with the GBP Directives in that area.

One Philips Ethics Line

To encourage and enable employees to report violations of the Philips General Business Principles and related policies and to submit complaints anonymously, if desired, without fear that those complaints might lead to retaliation or disciplinary action, Philips has implemented the One Philips Ethics Line. Standardizing the use of guaranteed-anonymity hotlines, the global implementation of the One Philips Ethics Line was completed in 2006. This ensures that all alleged violations are registered and dealt with consistently within one company-wide system.

All reported alleged violations are investigated by the company in an orderly and structured fashion by its Compliance Officers. Results of such investigations might result in disciplinary actions, including termination. Due to country specific constraints, Germany (where the approval of worker's representation bodies is required) and France (where approval is required from the privacy authorities) did not participate in the One Philips Ethics Line as of today. Philips is, however, willing to respond to those particular requests to allow a comprehensive company-wide implementation.

A comprehensive communications campaign around the global implementation reminded employees, "We all have a responsibility for a healthy working environment and ethical business conduct." The campaign included posters, wallet cards for easy reference, extensive electronic communication and letters from the company's executive leaders. The One Philips Ethics Line enables employees to report their concerns in local language,

People are the key to growth

Engaged employees are, just like happy clients, a condition for growth. Management plays an important role in strengthening this motivation.

as the call center is able to take reports in virtually any language. Available 24 hours a day, 7 days a week, calls are taken by trained communications specialists at a call center managed by an experienced third-party company. Employees always speak to a person – not an answering machine – and calls will be treated with the utmost confidentiality.

Updated GBP Directives

To drive the practical deployment of the GBP, a set of directives has been published, including a Supply Management Code of Ethics and a Financial Code of Ethics. The GBP Directives were updated in 2006, reflecting ongoing developments in codes of conduct and business integrity legislation. The main updates related to Philips' endorsement of the UN Global Compact, policy on HIV/AIDS, health and safety policy, integrity and ethics in advertising, and in particular directives on the giving of gifts. To ensure compliance with the highest standards of transparency and accountability by all employees performing important financial functions, the Financial Code of Ethics contains, amongst other things, standards to promote honest and ethical conduct, and full, accurate and timely disclosure procedures to avoid conflicts of interest. The company did not grant any waivers of the Financial Code of Ethics in 2006.

To reinforce awareness of the need for compliance with the GBP, a web-based GBP training tool has been rolled out throughout the world, in 18 languages. In the first half of 2007, we aim to cover more than 90% of Philips employees with internet/intranet access. In addition, an interactive update of our casebook for dilemma training was published.

In 2006, an e-Learning Tool for job training of (new) compliance officers (including complaint-handling procedures and dilemma training) was rolled out. This course is mandatory for all GBP Compliance Officers and will be updated and retaken each year.

Reported complaints

In 2006 a total of 392 concerns were raised, compared with 318 in 2005. In particular, the global implementation of the One Philips Ethics Line since mid-2006 may have resulted in this increase. In the first half of the year, with the One Philips Ethics Line implemented in the Latin America region, the US and Philips Medical Systems worldwide, 79 of the concerns were raised by means of the hotline. In the second half of the year that number increased to 147.

The number of alleged violations relating to Principles 6 (Assets and information) and 7 (Business integrity) continues to decrease. To further this downward trend, training will remain a high priority, with development and roll-out of a train-the-trainer program and increased attention to the GBP on the intranet. In addition, the number of legal and risk assessments on relevant processes and procedures has been increased, and the GBP Directive on gifts has been reviewed and redefined to enlarge the scope to include the giving of gifts.

Corrective actions taken in 2006 include dismissal, warnings and job changes.

One concern can relate to multiple alleged violations of the General Business Principles. The table on the next page shows a breakdown of the alleged violations of the Principles. Data includes the Semiconductors division, which was divested on September 29, 2006.

Breakdown of alleged violations of the General Business Principles

as a % of total

Chapters	2004	2005	2006
1 General commitment			
1 General commitment	6.3	2.2	4.5
1.1 Human rights	0.0	0.0	0.0
1.2 Child, bonded and forced labor	0.0	0.0	0.0
1.3 Free market competition	3.0	0.0	0.0
1.4 Product safety	0.4	1.1	0.7
1.5 Privacy	0.4	0.5	1.7
1.6 Environmental protection	0.0	0.5	0.3
Total	10.1	4.3	7.2
2 Commitment towards customers			
Total	1.9	0.0	1.2
3 Commitment towards shareholders			
Total	0.4	0.0	0.3
4 Commitment towards employees			
4 Commitment towards employees	2.6	6.7	2.2
4.1 Right to organize	0.0	1.1	0.5
4.2 Health and safety	0.7	0.8	5.0
4.3 Equal and fair treatment	26.1	34.1	47.1
4.4 Wages and payment	0.0	5.4	4.0
Total	29.4	48.1	58.8
5 Commitment towards suppliers and business partners			
Total	0.0	8.9	5.7
6 Assets and information			
6.1 Use and protection of assets	23.9	19.6	12.6
6.2 Improper disclosure	3.0	4.6	3.0
6.3 Insider trading	0.0	0.0	0.0
Total	26.9	24.2	15.6
7 Business integrity			
7.1 Bribery; records of transactions	20.1	11.0	10.4
7.2 Third-party interests	11.2	2.2	0.5
7.3 Political payments	0.0	0.5	0.0
Total	31.3	13.7	10.9
8 Observance of the General Business Principles			
8.1 Sanctions	0.0	0.0	0.0
8.2 Whistleblower policy	0.0	0.8	0.3
8.3 Compliance	0.0	0.0	0.0
Total	0.0	0.8	0.3
Overall total	100.0	100.0	100.0

Engagement Index

in %

unfavorable neutral favorable



Source: Philips Employee Engagement Survey 2006
Number of responses: 81.818

Key 2006 activities

To help employees reach their full potential and to help the company achieve its growth objectives, we have sharpened our focus on boosting engagement and improving talent management. Activities in 2006 included implementing a One Philips approach to the engagement process, creating a common language and shared understanding of the roles of leaders, further developing our diversity and inclusion initiative, and launching master classes on people leadership.

Engaging for growth

The growth and success of Philips is directly tied to the engagement level of all employees. Research shows that someone who is engaged typically goes above and beyond the normal demands of the job; helps others with heavy workloads; volunteers for extra duties; looks for ways to perform jobs more effectively and has higher levels of customer satisfaction. Companies that score highly on engagement perform better and have a higher chance of achieving growth and sustaining that growth than companies with low scores.

We have implemented a more streamlined Engagement Survey, with a common, One Philips language. To achieve greater consistency and simplicity across Philips, all employees were surveyed at the same time using the same questions, which were updated and reduced in number from 40 to 36. Importantly, the survey is being followed up with improvement actions throughout the organization.

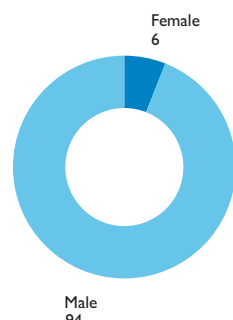
Record response rate

More than 100,000 employees were invited to give their input on the survey's 36 questions. The response rate of 85% is the highest ever.

Overall engagement, as measured in our Engagement Index, has improved from 59% to 61% favorable. The single measure of the overall level of engagement at

Composition of Philips executives (total=658) at year-end 2006

as a % of total



Philips, this index is a combination of satisfaction, referral and loyalty.

A look at the results

The results show that employees' trust in the Philips leadership is significantly higher and that the vision of the future Philips has communicated is a definite factor in our increasing engagement. Pride in the company and belief that it has an outstanding future emerged as clear strengths. Employees are also experiencing much more open and honest two-way communication in their work environments.

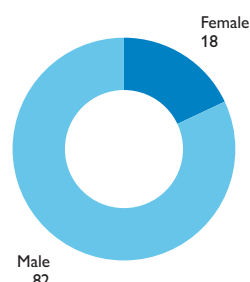
However, while the overall results are positive, there are two issues that are not yet strengths but need to become so. One is making the best use of employees' talents and abilities in their jobs; the other is the need for our management style to bring out the best in people. The main focus in 2007 will be on improving on the individual-focused items, to create the right conditions for our people to give their best every day.

Managers with teams of eight or more people received their team results, with some 3,500 reports generated. This is followed by "Deep Dive" sessions where managers begin a dialogue with their people. Managers, employees and HRM discuss the outcomes of their Engagement Survey on a business, department or team level. Strengths and weaknesses are discussed and corrective actions put in place to address areas of concern. This information is shared with employees through regular communication on progress.

Online dialogues

Taking action on employee feedback calling for more discussion and involvement in the Philips management agenda, we launched a series of three-day online dialogues in 2006 between employees and senior management. We kicked off the year with a dialogue on Growth and the management agenda 2006. That was followed by one

Composition of Philips Top Potentials at year-end 2006 as a % of total



on emerging markets, another on simplicity and concluded with a dialogue on engagement. The top 5,000 employees are invited to communicate directly with the Group Management Committee (GMC), and all employees are encouraged to let their managers know what they think about the topic so their opinions can also be shared during the dialogue.

Participants can log in from anywhere, at any time, and offer their views on a series of topics proposed by the organizers of the event. They can also comment on suggestions made by other participants. The emphasis is on interactive involvement and the GMC analyzes the input, which has proven to be candid and concrete. But what's more important is that lines of communication are opened and people are involved, with full details of each dialogue available on our global intranet site.

Diversity and inclusion

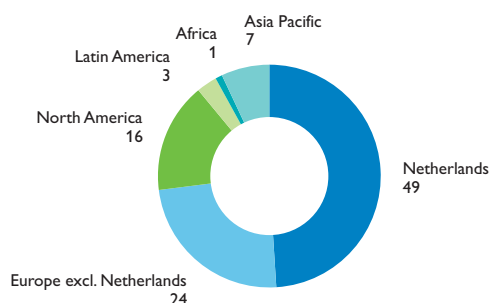
We have made diversity and inclusion (D&I) part of our Leadership Journey initiative. No longer a stand-alone activity within Human Resources, D&I is being embedded into existing processes like recruitment and talent development. For example, we track D&I indicators for our talent pipeline and succession planning.

To ensure we reach our goals to increase the percentages of women and other under represented groups in senior management positions, D&I is on the Group Management Committee agenda twice yearly. 2006 also saw the introduction of D&I targets for each division. D&I Champions from every business and region provide a vital link between the businesses and regions, and the corporate D&I team. This network has become more regionally focused to address region-specific D&I issues.

Raising awareness

During 2006, employees including Management levels in Asia, Europe and Latin America attended our one-day D&I Awareness Workshop in 2006. Inclusive Leadership

Regional origin of Philips executives at year-end 2006 as a % of total



workshops for our executive levels were held in all regions worldwide.

WINergy, our network for women, started as an executive's network in 2004. We began cascading the network to other levels in 2006 with a meeting in Amsterdam for non-executive females. This will be replicated in North America and Asia in 2007.

Making progress

We are continuing to focus on increasing the opportunities for under-represented groups in key positions, and on developing a diverse talent pipeline. Specifically, in addition to our overall diversity targets, we have set targets for each division and function, and follow these up with concrete action plans.

In keeping with our goals, the percentage of women rose to 6% in 2006 from 5%. The percentage of women in the top potential pool was 18% in 2006, compared with 11% in 2005.

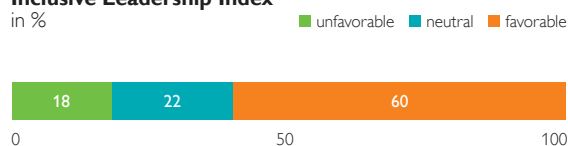
Further, we want to increase the percentage of executives from Asia Pacific. This percentage remained stable at 7% in 2006, while the percentage of top potentials from Asia Pacific increased to 18% from 13% in 2005.

The top potential data above, previously based on confirmed top potentials, now includes both nominated and confirmed top potentials. This provides a more complete picture of the talent pool and explains, in part, the differences in percentage compared with 2005.

Inclusive Leadership Index

We want a working environment that is inclusive and leaders who not only respect differences, but also make the most of them: leaders who understand that diversity and inclusiveness provide a competitive advantage. Our Inclusive Leadership Index focuses on diversity and inclusion and has been created to strengthen D&I within

Inclusive Leadership Index in %



Source: Philips Employee Engagement Survey 2006
Number of responses: 81.818

Philips. This Index is a combination of five survey items from our 2006 Engagement Survey related to the way we treat our colleagues, encourage diverse perspectives and bring out the best in each other.

The item asking whether "diverse perspectives are valued" has improved by 9% points and is one of the key drivers for our people. The main area of improvement is on equal opportunities, which is 50% favorable.

Developing our people

Employees across the globe can access detailed information about our Global Learning Curricula and register for courses online thanks to "Learning @ Philips" our Global Learning Portal, launched in August 2006. They can find learning programs to develop themselves and others in a user-friendly One Philips platform.

In 2006, more than 14,500 employees participated in programs in the Core Curriculum, an increase of 3,500 compared with the previous year. Our Core Curriculum offers learning opportunities in the areas of personal effectiveness, people management and business acumen.

We continued to add to our Functional Core Curricula, launching HR and IT, as well as a limited number of Finance classes, which will be expanded in 2007. With enrolment of 5,300 during 2006, we achieved our goal of significantly increasing participation in the Functional Core Curricula from 1,600 employees in 2005.

People Leadership Index

in %

■ unfavorable ■ neutral ■ favorable



Source: Philips Employee Engagement Survey 2006
Number of responses: 81.818

Talent pipeline curriculum

The Talent Pipeline Curriculum consists of systematic, accelerating and inspiring learning interventions for the Philips talent pool (from early career potentials to executives). Our advanced learning experience for high potentials, called Inspire, is designed to develop future leaders who are able to combine a thorough understanding of their business environment with excellent personal skills. The Octagon program is the accelerating development program for top potentials, offering participants the opportunity to use the strategic insight, knowledge and skills required to tackle a major (cross-divisional/cross-regional/cross-functional) issue, and round out their Philips leadership behavior.

We conducted three project assignments for Inspire and another 12 for Octagon, all closely tied to growth. One of our Inspire teams, for example, went to India to explore business development opportunities. All of the Octagon teams consisted of participants from across divisions, regions and functions.

Executive education

To help our executives to continue to develop their careers and strengthen their leadership skills, we offer a curriculum of internal and external programs.

In 2006 we launched a new executive education policy and Internet site focused on external business school programs. Such programs support the continuous career development of our senior management, and also provide input from thought leaders, as well as exposure to professionals from other organizations. The new executive education policy and website have been created to ensure executives and top potentials regularly attend programs that match their personal development needs. This new policy underlines our commitment to the development of our most senior people.

We introduced Master Classes on people management topics in 2006, including our Coaching Master Class and Engagement Master Class, which all executives will attend in 2007.

People Leadership Index

Because managers contribute significantly to the engagement of their employees, we have developed the People Leadership Index, which focuses on overall people leadership effectiveness. This measure allows individual managers to understand how the employees in their team perceive their ability to lead. This index is a combination of 12 engagement survey items related to managerial and leadership behaviors (passion and pride, bringing out the best and trust). This year the People Leadership Index for Philips overall is 59%, which we believe is a respectable start.

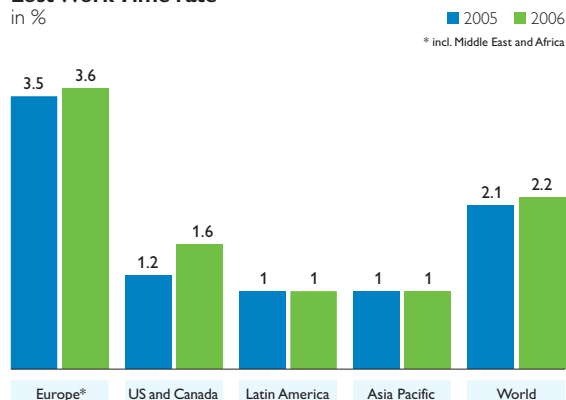
Responsible transformation in Europe

We will continue to act responsibly, safeguarding the interests of employees and will accelerate efforts to improve employability to ensure that employees are equipped to change jobs, either within or outside the company, quickly and smoothly.

The sale of our Semiconductors division affected some 35,000 employees globally, 13,500 of them in Europe, from the division itself and the areas that supported it, including Research, Applied Technologies, Legal, Treasury and IP&S. Until the company completed its sale of its majority stake on September 29, 2006, Philips kept employees well informed through a variety of channels such as videos from Semiconductors management, online and face-to-face communications. We also provided information to employee representatives, including the European works council and local works councils and unions, according to local law and common practice, so representatives could discuss key issues, including bridging service, labor conditions, pensions, etc.

Lost Work Time rate

in %



Ensuring employability

We published a statement on employability within Philips in Europe, drafted by the Philips European Works Council, known as the European Philips Forum (EPF). The responsible transformation approach we are applying within Europe stresses the fact that good employability is crucial in view of the continually changing competitive environment. The company and the EPF believe employees need to be made more aware of the importance of good employability.

We are taking a proactive approach to enhance workers' employability, running many activities to reinforce the importance of this issue. For example, our Lighting facility in Turnhout, Belgium, conducts workshops to help employees determine the competencies they need to develop.

Health and safety

Philips strives for an injury and illness free work environment. To drive improvement we set performance goals for the company and for our individual divisions.

We deeply regret to report the loss of two Philips employees. Both lost their lives in car accidents. The first occurred in June 2006 at the former Semiconductors facility in Seremban, Malaysia. Six other employees were hospitalized. In November a Consumer Electronics employee at Leuven, Belgium, suffered a car accident on his way to a meeting.

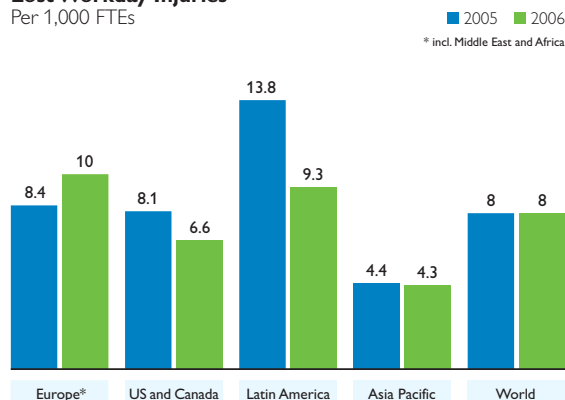
For reasons of comparability, we have excluded the data for Semiconductors for 2005 and 2006. Additional data are available in the online version of this report.

Lost Work Time rate

Based on data covering 85% of all Philips employees, the Lost Work Time rate remained virtually unchanged in 2006, with 2.2% of the contractual working hours lost due to sick leave. Approximately 0.1% was caused by occupational illness and injuries. The Lost Work Time

Lost Workday Injuries

Per 1,000 FTEs



rate for Europe is more than double the rate in other regions. This can be explained by cultural factors, as well as applicable legal and contractual compensation systems. The increase in the US and Canada is mainly attributable to different reporting procedures in the US for maternity leave in 2006.

Lost Workday Injuries

In 2006 we recorded 829 occupational injury cases causing the injured employee to be unable to work on the day after the injury (Lost Workday Injuries). Lost Workday Injuries reported in 2005 amounted to 846. The rate of Lost Workday Injuries was 8 per 1,000 employees, both in 2005 and 2006. We consider this level of injuries to be too high compared with industry benchmarks.

In 2005 we concluded that just over half of the Lost Workday Injuries are reported by our Lighting division. Therefore, the Business Group Lamps introduced a program in 2006 to reduce the frequency and severity of occupational accidents. This initiative includes the exchange of best practices.

Our environmental performance



Key global challenges

The significant issues for our company – and our industry – in the environmental area continue to be energy efficiency, chemical content of products, and take-back and recycling. We remain committed to giving our full attention to these challenges. At the same time we are maintaining our focus on overall environmental performance improvement, driven by our EcoVision III action program.

Climate change

The world's concerns about climate change increased in 2006, giving it considerable attention on the public and political agenda. This is not new to Philips. We were at the forefront more than three decades ago when we took decisive steps to optimize our environmental performance. Over the years we have developed considerable expertise in improving our products and processes, and have long focused on energy reduction and the associated issue of CO₂ emissions.

Energy-using products

The European Commission continues its sharp focus on energy efficiency of products, unveiling its Energy Efficiency Action Plan in October 2006. As a major step toward meeting the energy challenges facing the European Union, the plan calls for “saving 20% by 2020.”

Highlights

- More than 200 Green Flagships products on the market
- 24% more Green Flagships in 2006
- Total sales of Green Flagships of EUR 2.2 billion

We began optimizing our environmental performance more than three decades ago

Two of the mechanisms for achieving this goal relate to our business: the EU directive on the eco-design of energy-using products (EuP) and the EU energy labeling directive.

EuP aims at improving the environmental performance of products throughout their life-cycle by systematic integration of environmental aspects at the earliest stage of their design. Studies were started in 2006 that will lead to legal requirements on specific products and sectors. Philips represents the consumer electronics/information and communications technology industry on the Stakeholder Consultation Forum, which provides input on drafts that go to the EU's regulatory committee and eventually to the European legislative institutions, to be passed as legislation under the EuP umbrella.

The EU energy labeling directive applies to such products as refrigerators, washing machines and lamps. This will likely expand to new product sectors, considering that consumer electronics are the fastest growing type of products in people's homes and will be the largest by 2010.

The EU laid out its plans to use EuP and energy labeling to further enhance energy efficiency in an increasing number of industry sectors.

Countries or states in other regions, such as California in the United States and Australia, are also gearing up to decrease energy usage and contribute less to global warming, through legislative measures.

Chemical content of products

To ensure human health and protect the environment, the EU has been working to prevent pollution from sources as diverse as lead in gasoline and chemicals in batteries. Recent legislation focusing on chemical substances is underpinned by the precautionary principle. This is in keeping with Philips' own longstanding belief that prevention is better than cure.

Registration, evaluation and authorization of chemicals

The European Union's REACH Regulation (registration, evaluation and authorization of chemicals) will go into force on June 1, 2007.

Under REACH, producers and importers of chemicals will be required to register an estimated 30,000 substances in a central database, providing information about the chemicals' properties, effects and uses, and safe ways of handling them. Information is to be passed down the chain of production, with producers and importers obliged to provide this information on to everybody who uses chemicals in their production processes.

Restriction of hazardous substances

The EU's Directive on the restriction of the use of certain hazardous substances in electrical and electronic equipment, known as RoHS, went into effect on July 1, 2006. This legislation bans the placing on the EU market of new electrical and electronic equipment containing more than the agreed levels of the heavy metals cadmium, lead, mercury, hexavalent chromium and flame retardants polybrominated biphenyls and some polybrominated biphenyl ethers.

Driving innovation

We have long seen environmental improvement as an opportunity for innovation and are sharpening our focus on energy efficiency.

Our global policy applies the EU RoHS requirements to all of the markets we serve. While medical equipment is currently not in the scope of the RoHS legislation, our Medical Systems division is proactively eliminating these substances where possible.

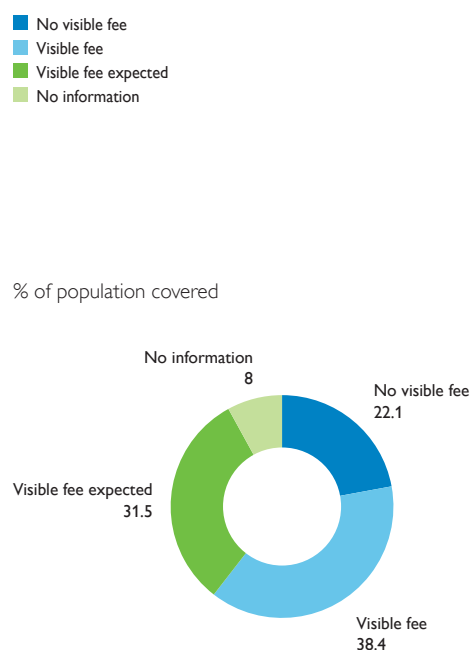
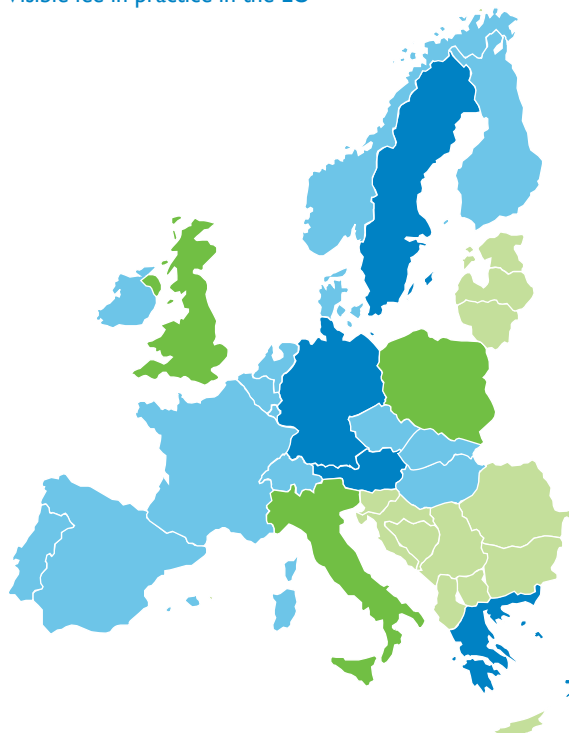
Given the variety of products in our other divisions, it took years to prepare for this legislation. During the final stage the main focus was on closely monitoring goods flow in several regions to ensure that all stock was fully compliant.

Other countries have been watching the EU RoHS legislation and have or will implement similar schemes, as is the case in China, Korea and in California in the US.

Legislation is not fully harmonized, making it necessary to deal with differences on a region-by-region basis. This can result in regional deviations from our global policy for specific product types.

Finally, Philips is playing a leading role in setting international standards on compliance and understanding of RoHS, working in close cooperation with the International Electrotechnical Commission (IEC). The IEC prepares and publishes international standards for all electrical, electronic and related technologies. These serve as a basis for national standardization and as references when drafting international tenders and contracts. We have representatives on several IEC technical committees related to regulated substances.

Visible fee in practice in the EU



Take-back and recycling

The EU Directive on waste electrical and electronic equipment (WEEE) makes producers responsible for taking back and recycling electrical and electronic equipment. Legislation related to WEEE varies by country and some countries (the UK and Italy) have not yet put legal requirements in place. This makes implementation complex.

We favor the visible fee for take-back and recycling, which consumers pay at time of purchase. This creates transparency and consumer awareness. Many European countries have adopted or plan to adopt the visible fee, as illustrated.

Our approach is to cooperate with industry partners to set up take-back schemes, selecting logistics and recycling companies in the individual member states.

EcoVision III (2006-2009)

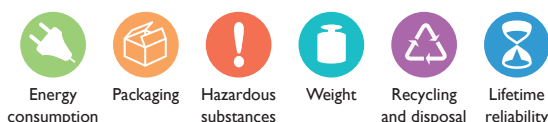
Our EcoVision III environmental action program began in 2006 and will run through 2009. In developing this program, societal relevance provided the foundation for a focus on the environmental issues stated earlier – energy efficiency, chemical content of products, and take-back and recycling, which are Green Focal Areas for product development. Further, we are continuing to work on optimizing our processes, striving to significantly reduce or eliminate emissions of the hazardous substances on the next page.

Additional details on our performance can be found in the online version of this report.

Products

Our EcoDesign process, introduced in 1994, deals with all phases of product development. Our top EcoDesigned products achieve Green Flagship status after undergoing a benchmark analysis. A Green Flagship is defined as a product or product family that offers better environmental performance than a predecessor or the best commercial competitor with comparable functionality.

This Green Flagship concept, launched with our first EcoVision program in 1998, calls for improvements in the following Green Focal Areas:



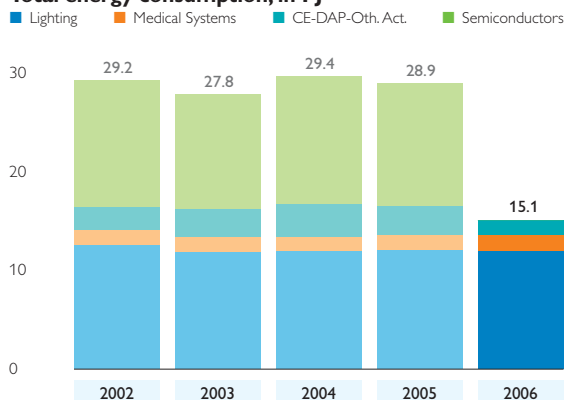
To achieve Green Flagship status, a product must be investigated in at least three Green Focal Areas, including energy consumption. In addition, the Life Cycle Score needs to be calculated and improvement criteria met. A detailed definition is available in our online report.

Green Flagships 2006

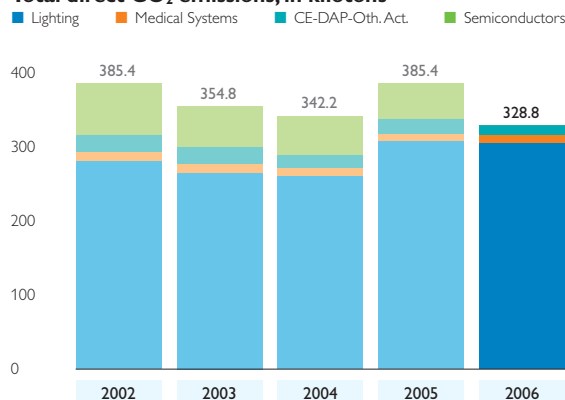
The year 2006 saw the introduction of 57 Green Flagship products on the market, a 24% increase from 46 in 2005. The full list of 2006 Green Flagships can be found on page 72.

The total number of Green Flagships on the market is more than 200, with total sales of EUR 2.2 billion.

Total energy consumption, in PJ



Total direct CO₂ emissions, in kilotons



Processes

Divestments

The company's divestment of the Semiconductors division, as well as other smaller divestments, accounts for a drastic reduction in energy, water and PFC use, comparing 2006 to 2005. Energy use fell by 48%, water by 74% and PFCs dropped by 94%. To allow for comparisons in the following analyses, results of divested entities have been excluded from all 2005 data.

In light of these divestments and ongoing changes in legislation, we recognize the need to re-evaluate our EcoVision III program and targets.

Energy

Absolute energy use is up slightly, by 1%, at 15,124 GJ in 2006. Taking into account a production increase of 7%, energy efficiency improved 6%.

CO₂ emissions

We are reporting 329 kilotons of direct CO₂ emissions in 2006, compared to 328 kilotons in 2005, mainly resulting from using natural gas. This 0.3% increase is directly related to the slight rise in energy consumption.

PFC emissions contribute to global warming and are expressed in CO₂ equivalents. With the sale of the Semiconductors division, PFC emissions are emitted at only one Medical Systems site, at the level of 32 kilotons CO₂ equivalents in 2006, compared to 30 kilotons CO₂ equivalents in 2005. The difference is attributable to process fluctuations.

The use of air-conditioning refrigerants and the use of CFCs and HCFCs in manufacturing result in emissions that contribute to global warming. Expressed in CO₂ equivalents, the 2006 emissions were 5.5 kilotons, compared with 5.3 kilotons in 2005.

Water

Water is essential in the manufacture of semiconductors. It is now used mainly for domestic purposes, except by Lighting, which is responsible for 77% of total water use.

In absolute terms, water usage increased to 4,127 thousand m³ in 2006 from 4,080 thousand m³ in 2005, representing a 1% increase. As production went up approximately 7%, the efficiency of water usage improved 6%. In 2006, the ratio of purchased water to that we extract is approximately 5:3.

Waste

Total waste remained virtually stable at 126 kilotons in 2006. Lighting (64%) and Consumer Electronics (21%) share 85% of our worldwide total waste. Consumer Electronics accounted for a slight increase, due to rising packaging waste from overseas contractors combined with a changeover to larger TV panel sizes.

Total waste is made up of actual waste that is delivered for either landfill or incineration, comprising 17% non-hazardous and 4% hazardous waste, and recyclable waste. Materials delivered for recycling via an external contractor comprised 99 kilotons, which equals 79% of total waste.

Restricted substances: benzene emissions

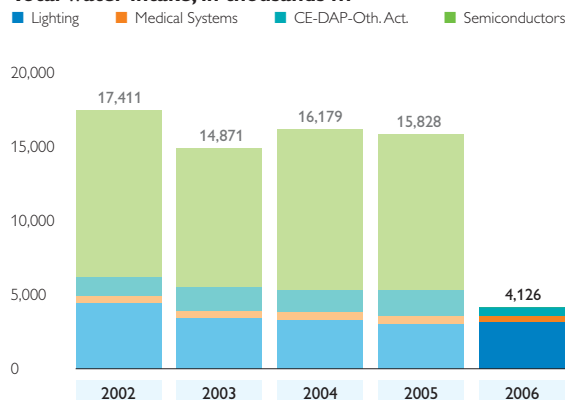
Lighting is the only product division that uses benzene in manufacturing and this has decreased from 20 kg in 2005 to 6 kg in 2006. The remaining site using benzene plans to eradicate its use in 2007.

Restricted substances: mercury emissions

Mercury is used exclusively by Lighting in production. In keeping with our program, emissions were reduced 24%, to 197 kg in 2006 from 260 kg in 2005.

Restricted substances: CFCs/HCFCs

In 2005, total emissions from CFCs and HCFCs was 2,8 kilotons. The total in 2006 is 108 kg, mainly used in

Total water intake, in thousands m³

Medical Systems. This 96% reduction was achieved by eliminating the use of some HCFCs, as well as changes in product mix and a manufacturing process.

Other restricted substances

The total of 4.4 kilotons, largely attributable to Lighting, decreased compared with the total of 5.1 kilotons in 2005.

Hazardous substances: lead

In 2006 a total of 4.2 kilotons of lead emissions were reported, stable compared to 2005. Lead is mainly used in soldering at Lighting facilities outside of Europe. In keeping with our EcoVision target to reduce the use of lead in our processes, elimination programs are underway.

Hazardous substances: toluene

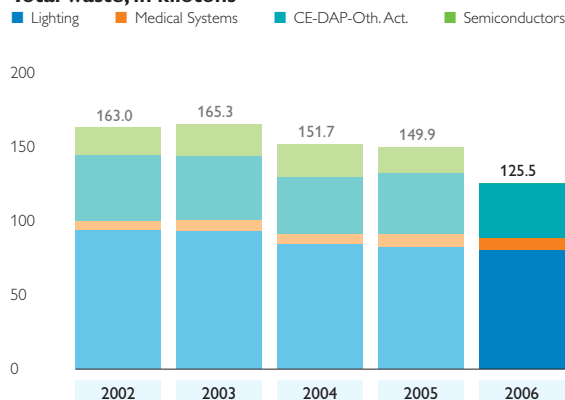
Toluene emissions have been reduced 67% in 2006 to 2.9 kilotons from 8.9 kilotons in 2005. Two Lighting sites have eliminated the use of toluene, while another had a decrease due to a change in product mix and phase-out of operation.

Hazardous substances: xylene

87% of the 2006 total xylene consumption was reported by Lighting, with DAP accounting for 12%. Total amounts reported are 4.3 kilotons in 2006 compared to 3.6 kilotons in 2005. The increase is attributable to changes in product mix and higher demand. In view of the EcoVision targets, elimination programs are in place.

Other hazardous substances

The total of other hazardous substances (including antimony, specific chlorinated/brominated organic compounds and styrene, reported in 2006 is 90 kilotons) compared to 97 kilotons in 2005. 87% of this total is attributable to the Lighting division in the form of styrene.

Total waste, in kilotons**ISO certification**

Company policy requires that all manufacturing sites achieve ISO 14001 certification. The company also recommends that non-industrial facilities obtain certification.

At year-end 2006, 93% of our industrial reporting organizations were ISO 14001 certified.

Legal compliance

Compliance issues are resolved through local management with legal counsel.

For information about provisions for environmental remediation please refer to the *Philips Annual Report 2006*.

A fine of EUR 16,050 relating to an incident was reported.

Incidents

In 2006, 16 incidents were reported in eight categories. They were related to water (three), waste (three), soil (three), noise (two), packaging (one), and emissions of restricted substances (two), hazardous substances (one) and relevant substances (one).

Our economic performance



2006 was a landmark year in the history of Philips, one that included the sale of a majority stake in the Semiconductors division, the further disposal of cyclical, non-core activities and a number of strategically aligned acquisitions, targeted at high-growth, high-profit areas.

Economic stakeholders

From a sustainability perspective, there are many stakeholders who have a direct or indirect economic interest in our company's performance. Direct economic impacts are often measured as the value of transactions between the reporting organization, the Philips company and its stakeholders. Our suppliers and employees are the main ones in terms of transactions.

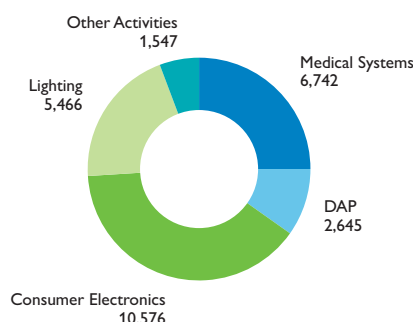
Indirect impacts are important to assess and report in relation to local communities and regional economies. These indirect economic impacts are an indication of where reputational risks may develop, or where opportunities may emerge to expand market access or a social license to operate. In this report, however, we limit the scope to direct economic impacts on a global level to represent the company as a whole.

Highlights

- Sale of majority stake in Semiconductors
- Continuation of share repurchase program
- EBIT margin of 4.4%
- Increase of 9% in market capitalization

Sales per sector 2006

in millions of euros



Customers

Sales of the Philips Group

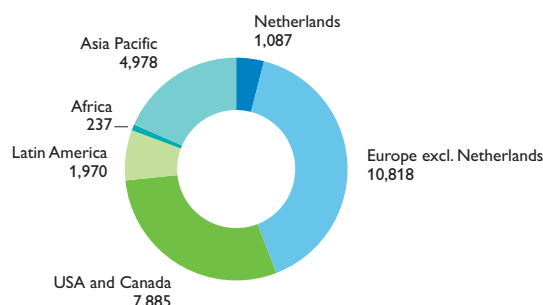
Longer-term success for any company is based on loyal and satisfied customers. Sales in 2006 increased by 6% on a comparable basis, compared to 2005 (5% nominally). Medical Systems (+7%), Domestic Appliances and Personal Care (DAP) (+11%), Consumer Electronics (+5%) and Lighting (+8%) all posted significant comparable sales growth. Nominal sales growth of 5% was mainly driven by DAP (+21%, boosted by the acquisitions of Lifeline and Avent) and Lighting (+14%, boosted by the acquisition of Lumileds). The overall sales increase in the main operating sectors was partly offset by a 24% nominal sales decline in Other Activities, affected by the divestments of Optical Storage, Philips Business Communications and Philips Enabling Technologies Group.

Geographic sales distribution

In 2006, sales in Europe showed a strong increase of 8% on a comparable basis, with divestments having a downward effect of 3%. Comparable sales growth was visible in all sectors, led by double-digit growth rates at DAP and CE (both 10%), followed by Lighting and Medical Systems.

Sales per geographic area 2006

in millions of euros



Comparable sales in the emerging markets in Eastern Europe showed a 19% increase, with double-digit growth rates evident in all operating sectors, notably in Medical Systems with 33%. Russia and Ukraine, accounting for around 40% of the company's sales in Eastern Europe, showed strong sales growth of 27% and 57% respectively.

Sales in North America increased by 5%, both nominally and comparably, and were particularly strong in DAP, with a growth rate of 11%, predominantly attributable to sales of Oral Healthcare products. Sales of CE and Medical Systems improved by 7% and 6% respectively.

Asia Pacific posted 2% comparable sales growth in 2006. Strong increases in DAP (15%), Medical Systems (14%) and Lighting (13%) were partly offset by a comparable decline in CE sales.

Sales in Latin America grew by 8% comparably, with strong double-digit sales growth in most of the countries, and a 5% sales increase in Brazil. All sectors reported increased sales, led by DAP and Lighting, followed by CE and Medical Systems.

Employees

Wages

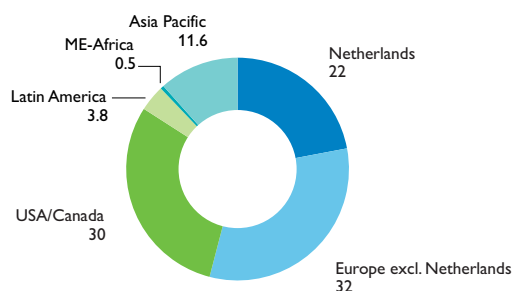
The composition of our workforce and the changes in 2006 have been addressed in the employee section of this report. The total wage bill in 2006 was EUR 6,906 million, virtually unchanged from the year before. Excluding the discontinued operation of Semiconductors, the wage bill increased 5.6%.

Pensions

Net periodic pension costs of defined-benefit pension plans amounted to EUR 75 million in 2006 (2005: EUR 157 million). The contributions to defined-contribution pension plans amounted to EUR 80 million (2005: EUR 59 million). The new accounting rule for pensions and other post-retirement benefits (SFAS No. 158) requires Philips

Going forward, we will build upon the growth and value creation momentum we have developed over the past few years

Wage bill per geographic area in 2006
as a % of total



to post the funded status of pensions and other post-retirement benefit plans on the balance sheet. As a consequence, actuarial gains and losses will directly affect stockholders' equity through changes in other comprehensive income, while there will no longer be any additional minimal pension liability. These changes resulted in a reduction of stockholders' equity of EUR 477 million in 2006. This new accounting standard has no impact on the company's income statement.

Suppliers

Total products and services purchased in 2006 amounted to EUR 18.7 billion, representing 69% of total sales. We are in the process of an ambitious change program by reducing the number of suppliers, particularly for Non-Product-Related spend. This drive plays a strategic role in value creation for our company and stimulates suppliers to be strategic partners for the future. Further details on supply spend are included in the following section.

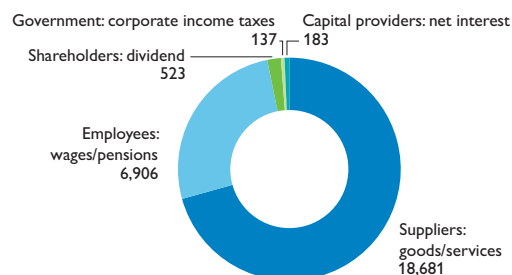
Providers of capital

The total amount of net interest expenses decreased from EUR 197 million to EUR 183 million in 2006, mainly as a result of higher average cash positions and higher average interest rates applied to these cash positions. This was offset by increased interest expenses on derivatives related to hedging of the Group's foreign-currency-denominated cash and intercompany funding positions.

Shareholders

Economic benefits for the shareholders include several aspects. The direct impact relates to payments of dividends, totaling EUR 523 million in 2006, or EUR 0.44 per common share. Another direct effect came from the repurchasing of 100 million shares, thereby returning EUR 3.3 billion to shareholders including the annual dividend.

Distribution of direct economic benefits 2006
in millions of euros



Governments

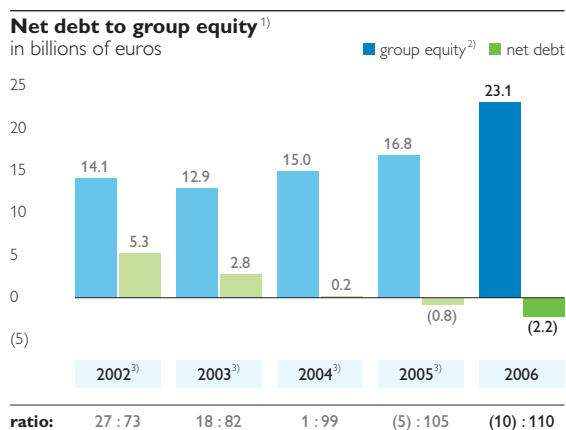
Income taxes amounted to EUR 137 million, compared to EUR 506 million in 2005. Income taxes in 2005 included EUR 240 million of withholding taxes related to the transfer of TSMC shares to the company from its fully owned subsidiary Philips Electronics Industries Taiwan, partly offset by tax gains of EUR 109 million relating to final agreements on prior-year taxes in the US. Income taxes in 2006 were positively impacted by a reduction of the Dutch corporate tax rate (EUR 70 million) and tax gains of EUR 40 million relating to final agreements on prior year taxes in various jurisdictions. The tax burden in 2006 corresponded to an effective tax rate of 11.3% on the pre-tax income. The effective tax rate in 2006 was affected by tax-exempt items such as TSMC dividends, as well as the gains and losses resulting from changes in the fair value of TSMC stock and TPV bond options.

Financial performance in 2006

For a full understanding of the company's financial performance in 2006, please refer to the *Philips Annual Report 2006*.

Gross margin of EUR 8,295 million increased by EUR 354 million compared to 2005, driven by the sales growth. Gross margin as a percentage of sales slightly declined, from 30.8% in 2005 to 30.7% in 2006. The sales-driven improvement was partly offset by a EUR 256 million charge, primarily related to an additional accrual for unasserted potential future claims in respect of asbestos related product liabilities, net of insurance recoveries.

As a percentage of sales, selling expenses (17.3%) and research and development (R&D) expenses (6.2%) were the same as in 2005. General and administrative (G&A) expenses, however, increased both in nominal terms (+ EUR 180 million) and as a percentage of sales, to 3.7%. In 2006, additional implementation costs related to compliance with section 404 of the US Sarbanes-Oxley



¹⁾ For a reconciliation to the most directly comparable US GAAP measures, see the chapter Reconciliation of non-US GAAP information in the *Philips Annual Report 2006*.

²⁾ Stockholders' equity and minority interests

³⁾ Restated to present the Semiconductors division as a discontinued operation

Act were required, while 2005 included a EUR 121 million release of a post-retirement medical benefits provision.

EBIT amounted to EUR 1,183 million in 2006, compared with EUR 1,472 million in 2005, reflecting – among other things – a EUR 256 million charge for asbestos related product liabilities in 2006 as well as a EUR 136 million gain on the TPV transaction and a EUR 170 million release of a post-retirement medical benefits provision, both in 2005.

Sales and EBIT 2006

in millions of euros unless otherwise stated

	sales	EBIT	as a % of sales
Medical Systems	6,742	795	11.8
DAP	2,645	386	14.6
Consumer Electronics	10,576	416	3.9
Lighting	5,466	635	11.6
Other Activities	1,547	(448)	(29.0)
Unallocated	–	(601)	–
Philips Group	26,976	1,183	4.4

Net income amounted to EUR 5,383 million, compared to EUR 2,868 million in 2005, primarily as a result of the sale of a majority stake in the Semiconductors division.

Cash flows from continuing operations decreased from EUR 1,141 million in 2005 to EUR 342 million in 2006, mainly due to higher pension contributions in the United Kingdom and United States.

Net debt to equity ratio improved further to (10):110, allowing us to pursue for growth.

Key data

in millions of euros unless otherwise stated

	2004 ¹⁾	2005 ¹⁾	2006
Sales	24,855	25,775	26,976
% increase, nominal	3	4	5
% increase, comparable	8	4	6
EBITA	1,864	1,577	1,382
as a % of sales	7.5	6.1	5.1
EBIT	1,156	1,472	1,183
as a % of sales	4.7	5.7	4.4
Net income	2,836	2,868	5,383
Net operating capital (NOC)	4,524	5,679	8,724
Cash flows before financing activities	2,666	2,828	(2,469)
Employees (FTEs)	161,586	159,226	121,732
of which discontinued operations	35,116	37,417	–

¹⁾ Restated to present the Semiconductors division as a discontinued operation

Research and development

Philips' research and development expenditures totaled EUR 1.7 billion, or 6.2% of sales, the same percentage as in 2005. Investments in innovative technologies increased especially in the areas of Healthcare & Wellness and Lighting & Visual Experiences to 42% and 20% respectively. In 2006, 53% of the group's sales came from newly introduced products.

A significant increase in sales from new products compared to 2005 was visible in CE, Lighting and DAP. Medical Systems' sales from new products remained well above the group level of 53%. Philips aims to increase the share of new products in total sales further above 50%, while at the same time focusing on the profitability of new products.

Our suppliers



Our mission for supply management is to create value by extracting the power of One Philips and transforming the transactional purchasing function into strategic supply management.

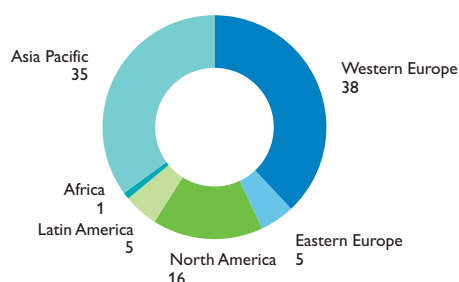
2006 marked the third year of an ambitious change program. To date, all program goals have been achieved: 70% of Philips' spend is now centralized or center-led, and supply management plays a strategic role in value creation for the company. Between 2003 and 2005, the total number of suppliers was reduced to less than 25,000 from more than 50,000. Now we are focusing on concentration of spend: 80% of our Bill of Material spend is concentrated with fewer than 250 suppliers, and 80% of Non-Product-Related spend with 1,450 suppliers.

The transformation process, including leveraging of opportunities in emerging markets accounting for more than 45% of our spend, has consistently resulted in major savings performance over the past three years. Industry experts have recognized this strong performance: a study carried out by a global management consulting firm, ranked Philips among the top quartile of the 200-plus companies surveyed.

Highlights

- **Strengthened supplier sustainability governance**
- **Endorsed Electronic Industry Code of Conduct**
- **Audited 98% of risk supplier sites**

Total purchased products and services in 2006, by geographic area
as a % of total



Supply Management staff utilizes best-in-class processes, tools and systems that support strategy supply management. Examples include SMART spend transparency tool, enabling analysis and optimization of spend; Global Supplier Rating System; Electronic Contract Management; and eSourcing, which generates substantial savings and includes eAuctioning. We have increased our eAuction spend to EUR 2 billion spend in 2006 – nearly 10% of total spend – compared with less than 1% in 2003.

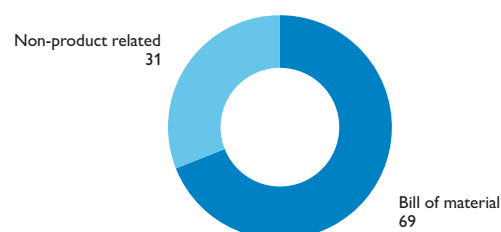
Strengthening supplier sustainability governance

Based on our governance model, each division is responsible for the compliance of its supply base.

2006 saw the appointment of the company's first Senior Vice President, Supplier Development and Sustainability, to further strengthen the governance of our supplier sustainability program and continue embedding sustainability throughout the supply chain. This position reports to the Chief Procurement Officer, who is a member of the Philips Group Management Committee and Chair of both the Supply Management Leadership Board and the Sustainability Board.

The Supply Management Leadership Board is responsible for program deployment and consists of the Chief Procurement Officers of each division. Our Supply

Total purchased products and services in 2006, by type
as a % of total



Sustainability Platform is comprised of Supply Sustainability Officers from each division and representatives from Corporate Legal, Corporate Sustainability Office and Internal Audit. Chaired by the Senior Vice President, this group leads our overall supplier sustainability program. Our supply managers are obligated to select suppliers that act with integrity and are in compliance with applicable laws and the Philips Supplier Sustainability Declaration as laid out in the Philips General Business Principles and Supply Management Code of Ethics. The divisional CPOs must approve new suppliers after assessing, among other things, the critical competencies of the proposed supplier.

Lead buyers play a pivotal role. They are responsible for communicating requirements to suppliers, requesting and scheduling audits, ensuring audits are executed and that corrective actions are implemented. If necessary, the CPOs support the lead buyers as they work with suppliers to facilitate changes in a supplier's operations.

Moving toward standardization

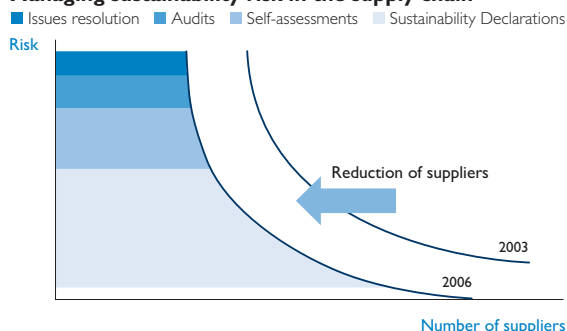
In July 2006 we endorsed the Electronic Industry Code of Conduct (EICC) and joined its Implementation Steering Committee. We believe that collaboration with our industry peers will create better impetus for social and environmental change within our supply chain. Working with the EICC member companies to develop a common approach, and standardized tools and processes, we can increase efficiency, productivity and simplicity for our suppliers and ourselves.

Reflecting our drive for consistency, the Philips Supplier Sustainability Declaration has been updated to align with the EICC standards. However, we have included an appendix with further requirements regarding freedom of association/collective bargaining, as this requirement was in our original Supplier Sustainability Declaration. This is in keeping with our General Business Principles and is expected by our stakeholders. Where freedom of association/collective bargaining is restricted by law, we

Embedding sustainability in our supply chain

We believe in asking our suppliers to share our commitment to sustainability. This includes sound environmental and ethical standards as well as providing working conditions for their employees that reflect the Philips General Business Principles.

Managing sustainability risk in the supply chain



look to see if there are other means of open communication between the supplier's management and workers.

Supplier Sustainability Program approach

The Philips Supplier Sustainability Program is built on the following pillars:

- Setting out our requirements
- Building understanding and agreement
- Monitoring suppliers
- Resolving issues.

To determine where to focus our efforts, we have developed an approach based on a risk profile related to spend, country of production, business risk and type of supplier relationship. The graphic above illustrates this risk-based approach.

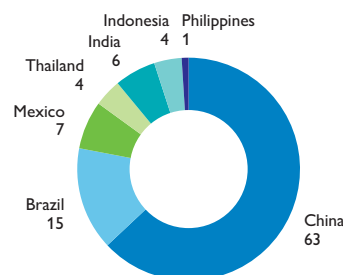
Setting out our requirements

We launched our Supplier Sustainability Involvement Program in 2003, raising awareness among our suppliers through training. This led to the signing of the Philips Supplier Declaration on Sustainability, which outlines our expectations of behavior in the areas of environment, health and safety, and labor conditions. Our Supplier Sustainability Declaration applies to our suppliers with a spend above EUR 1,000. We are in the process of implementing our renewed Declaration, which aligns with the EICC standards, in our Purchase Agreements and Purchase Orders. We expect to roll this out to our suppliers in 2007.

The Royal Philips Electronics List of Restricted Substances is also part of our Purchase Agreements. The list specifies those substances that are not allowed in products above our established threshold to ensure that all products put on the market do not contain substances restricted by law and regulations, including the European Union's Directive on the restriction of the use of certain hazardous substances in electrical and electronic equipment (commonly known as RoHS).

Distribution of risk supplier audits, 2006

as a % of total audits in risk countries



Building understanding and agreement

We work with our suppliers to raise awareness about the importance of operating in a sustainable manner and provide guidance on how to do so. Our divisions conduct training sessions, supplier day events or specific briefings. Regardless of the venue, suppliers are encouraged to share their experience.

In 2006 suppliers from around the world attended briefings in our development centers in Austria, Brazil, China, Hong Kong, the Netherlands, Singapore and the US. The China Sourcing Group, for example, organized a Supplier Forum for 40 Chinese suppliers. As an integral part of how we do business, sustainability was an important agenda item. In 2007 we will strengthen our activities in this area through participation in the EICC capacity building program. In partnership with the World Bank, the project aims to improve the sustainability performance of the electronics sector's supply chain in China.

We also continued to conduct training on the Philips Supplier Sustainability Program for our employees in 2006, including internal auditors, HR, Quality, site management, business groups and purchasers. Training was held at Philips sites around the world, including Brazil, China, Indonesia, the Netherlands, Thailand and the US.

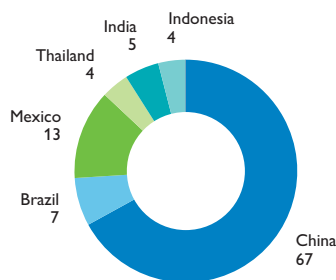
Monitoring suppliers

Our supplier self-assessment tool and audits are used to enable our divisions to monitor compliance with our requirements throughout our supply base.

Self-assessment tool

If the perceived risk goes above a certain level, suppliers are asked to perform a self-assessment. This further builds awareness, giving suppliers the opportunity to resolve issues internally. During 2006 we piloted a web-based self-assessment tool, derived from the EICC self-assessment tool, with 113 suppliers. Based on this experience, we are currently in the

Distribution of non-compliances by country, 2006
as a % of total in risk countries



process of re-evaluating the added value of the self-assessment tool.

Sustainability audit approach

For 2006 we set a target to achieve transparency by auditing 100% of our identified risk supplier sites. That is, we wanted to have a clear picture of the sustainability risks we may be facing with those risk suppliers we began working with prior to implementing our Supplier Sustainability Program in 2004. To help us determine our criteria, we identified risk countries based on independent sources and also determined a threshold based on spend.

Suppliers who provide us with goods from manufacturing sites in Brazil, China, India, Indonesia, Mexico, Pakistan, the Philippines, Thailand and Vietnam, and with whom we also spend more than EUR 100,000, were identified as risk suppliers. In addition, if suppliers are identified as risk suppliers outside this scope, they are also audited. Likewise, all potential suppliers that are identified as risk suppliers automatically undergo audits as part of the supplier selection and approval process. We do not work with potential suppliers until identified non-compliances are remedied.

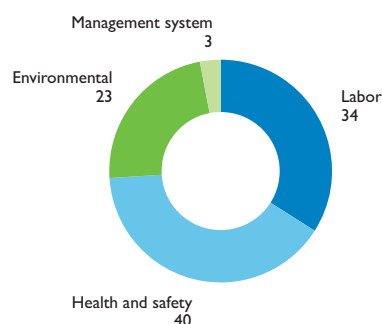
To achieve our transparency target it was necessary for us to increase our audit capabilities. After a thorough selection process, we began using SGS Group as an external auditor. This also will enable us to benchmark results between internal and external audit reports.

All auditors use the Philips audit tool, which has been aligned with the EICC where possible, and we will implement the EICC audit tool when it becomes available.

Overview of 2006 audit results

During 2006, we completed 365 sustainability audits, achieving 98% of our transparency target. Of that total, 305 audits took place at supplier sites with a spend above EUR 100,000, in Brazil, China, India, Indonesia, Mexico, the Philippines and Thailand. This includes 34 strategic

Distribution of non-compliances by grouping, 2006
as a % of total in risk countries



second-tier risk supplier sites (those we selected for our first-tier suppliers) and 93 audits conducted by SGS Group. The table on the next page provides a summary of the non-compliances found during these audits. While we have noticed some discrepancies in the quality of the audits conducted, we believe the results shown provide the transparency we aim for.

The most frequent sustainability non-compliances were identified in the areas of working hours, wages and benefits, emergency preparedness, occupational safety, and pollution prevention and resource reduction. In general, visible non-compliances, such as blocked emergency exits, are easier to identify than issues like discrimination. We also have experienced cases where suppliers try to cover up their non-compliances by keeping double records.

Looking at specific findings, non-compliances associated with working hours are most common in China and Thailand. This is frequently related to overtime not conforming to legal limits or where employees routinely work seven-day workweeks. One of the hurdles to ensuring that acceptable working hours are upheld is that exemptions are sometimes given by local authorities to suppliers.

Related to this, wages and benefits non-compliances show cases where salaries and overtime premiums are not paid in line with legal requirements. In some instances, workers are not aware of the wage system used to determine their pay calculations or the salary they are entitled to. This can perpetuate a cycle of long working hours, as employees (often migrant workers) seek to supplement their incomes in a limited time.

Emergency preparedness was found lacking at most of the supplier sites we audited. We noted unawareness about the need to have fire safety procedures and measures in place. The same applies for the use of personal protective equipment, which is the main finding in the area of occupational safety.

With respect to pollution prevention and resource reduction, the most frequently seen non-compliance was the absence of environmental management systems at the sites audited. We support suppliers with projects to implement such systems. One example is in Manaus, Brazil, where we help our suppliers achieve ISO 9001 and ISO 14001 certifications in collaboration with the UNCTAD.

At one of our supplier sites in China, three 15-year-old children, under the legal age of 16, were employed. We worked closely with the supplier to resolve the issue without hardship for the children and their families. We also worked with the supplier to ensure they implemented measures to prevent this from happening again. The supplier now has a proper age verification procedure in place, and during both of our follow-up visits was able to provide workers' age records. Further, we found instances in China where workers between the ages of 16 and 18 were working in unsafe conditions or during nightshifts.

In terms of humane treatment, the main non-compliances found were of suppliers that did not have policies or procedures against harassment or describing disciplinary measures.

We did not find any cases of suppliers trying to block worker initiatives for freedom of association or instances of dismissal of union/employee representatives. We did find cases where grievance and complaint procedures were lacking, as were general communication channels between worker representatives and management.

The new EICC audit tool will support us in our efforts to strengthen the scope and depth of our audits.

Summary supplier sustainability audit results 2006

% of audited sites in risk countries where the following types of non-compliances were found

	Zero tolerance	Major	Minor
Labor			
Freely chosen employment	●	●	●
Child labor avoidance	●	●	●
Working hours	●	●	
Wages and benefits		●	●
Humane treatment	●	●	●
Non-discrimination	●	●	
Freedom of association	●	●	
Collective bargaining		●	●
Health and safety			
Occupational safety	●	●	●
Emergency preparedness		●	●
Occupational injury and illness			●
Industrial hygiene		●	●
Dormitory and canteen			●
Environmental			
Environmental permits and reporting		●	●
Pollution prevention and resource reduction		●	●
Hazardous substances	●	●	●
Product content restrictions		●	●
Management system			
Company commitment	●		
Legal and customer requirements	●		●

● 0 ● 1<5 ● 15<25
 ● <1 ● 5<15 ● 25<50

Issues resolution process

	Resolution timeline	During resolution time	Non-compliance not addressed after resolution and escalation time
	Resolution process		
Zero tolerance	1 month	Use alternative supplier; no new project, prepare contingency plan	Stop ship
Major	3 months, depending on required time for implementation	Use alternative supplier if available, prepare contingency plan	Phase-out
Minor	As agreed with supplier	Business as usual Discuss in quarterly business review	Review new project allocation

Resolving issues

We take non-compliances very seriously and continuously monitor and support the implementation of corrective actions at our suppliers' manufacturing sites. In order to manage issues identified during an audit, we have categorized non-compliances into zero-tolerance, major and minor. This categorization determines both the appropriate timeline in which the supplier should complete corrective action and what internal escalation procedures we need to take.

After audits, the lead buyer works with suppliers to ensure that the supplier acts upon the required corrective action in the agreed timeline. In general, we prefer to resolve issues at operational level whenever possible, further embedding sustainability into the purchasing function. Most issues can be solved at monthly meetings with suppliers. Many health and safety issues, for example, can be solved quickly.

The resolution of zero-tolerance and major non-compliance issues is monitored using a cross-division escalation process. This process involves CPOs and business management, and is needed if business interests are vulnerable, including issues with single-source suppliers where we have few or no alternatives. Compliance officers have the responsibility to monitor this reporting process and internal audit has added the topic to its overall risk assessment with the divisions. The reporting of unresolved issues is also an integral part of the General Business Principles non-compliance reporting.

If a supplier does not make progress in implementing corrective actions, or if they continue to use unacceptable practices, we will end our relationship with them as a last resort. This decision may have an impact on our business and if so we carefully prepare a contingency plan.

Since 2005 we have discontinued working with one supplier specifically for sustainability reasons. In addition,

sustainability was one of the factors that led to ending our relationship with other suppliers, as part of our consolidation drive.

2007 activities

We will continue to strengthen our Supplier Sustainability Program, further embedding it throughout our supply management organization. Plans for 2007 include:

- Resolving the remaining issues identified in our audits. This includes conducting re-audits to monitor whether corrective actions have been properly implemented
- A differentiated approach to risk definition, looking at specific labor, health and safety, and environmental risks, as well as type of product or component
- Enhancing stakeholder dialogue, particularly with business associations and other companies to drive standardization and ensure a level playing field for our sector
- Further integration of sustainability into our supply management processes, such as making sustainability a routine topic during monthly business review meetings and continuous monitoring of corrective action implementation
- Improving internal monitoring systems to ensure resolution of non-compliances.

Appendixes

Our approach to reporting

Commitment to transparency and sustainability

At Royal Philips Electronics we consider transparency about our sustainability activities a vital part of living up to our heritage of sustainable entrepreneurship. We published our first environmental annual report in 1999, covering the 1998 fiscal year. We expanded our yearly reporting in 2003 with the launch of our first sustainability report, including the full spectrum of our sustainability activities with details on our social, environmental and economic performance.

This report provides information on the 2006 fiscal year, January 1, 2006 to December 31, 2006. Titled *Improving lives, delivering value*, it marks a new direction in our sustainability reporting. In addition to providing details on our performance in the three areas of sustainability, this report includes in-depth articles on key global challenges: energy efficiency, healthcare and development. We chose to explore these subjects because they are of increasing importance to the world and are areas in which we can make a significant impact, improving the quality of people's lives with our innovations.

Material issues

The special feature reports – as well as the information on our social, environmental and economic performance – have been identified as the most material issues to be explored. This selection is based on a blended approach, incorporating internal analysis (including our company strategy and risk assessment processes) and an outside-in perspective.

We review trend analyses from a variety of sources, including the World Bank, World Business Council for Sustainable Development, World Economic Forum and World Health Organization, as well as our own research. As a member of organizations like the World Business Council for Sustainable Development and the Electronic Industry Code of Conduct, we participate in meetings and task forces, bringing new learning to bear. Our work

also involves tracking topics of concern to governments, regulatory bodies and non-governmental organizations, and following the resulting media coverage. In 2006 we strengthened this approach with a refreshed plan to increase and improve stakeholder dialogue. This includes a bottom-up issues management grid and stakeholder outreach, discussed on page 41.

Three methods of delivery

In keeping with our brand promise “sense and simplicity” we shortened our 2005 print report, moving background information and additional details to our website. This evolution continues both in terms of content and delivery, with the *Philips Sustainability Report 2006*, which is available in three ways:

- A print document
- A downloadable PDF version of the print report, on our website at ➔ www.philips.com/sustainability
- An expanded online report with additional information from 2006 and relevant material from previously published reports, also available at ➔ www.philips.com/sustainability

Reporting standards

In compiling this report, we have followed relevant best practice standards and international guidelines, including the *Global Reporting Initiative's (GRI) 2002 Guidelines*. (Philips has been a GRI Organizational Stakeholder since 2004.) In addition, we considered our transition to the *G3 Sustainability Reporting Guidelines*, which were formally launched in Amsterdam on October 5, 2006. This involved sharpening our focus on the principles of materiality, stakeholder inclusiveness, sustainability context and completeness. The results can be seen throughout the report.

With regard to the GRI Application Levels system introduced with G3, we see ourselves currently positioned at the B+ level. We cover a large part of the new Core Indicators, while our Management Approach

is explained in this report and in our previous sustainability reports. A detailed overview of Core Indicators is provided on our website at www.philips.com/sustainability

Scope of this report

This report describes the sustainability performance of the Philips Group, covering the total of the consolidated Philips activities following the consolidation criteria detailed in the *Philips Annual Report 2006*.

The Philips Group consists of the following sectors for the reporting year 2006:

- Medical Systems
- Domestic Appliances and Personal Care
- Consumer Electronics
- Lighting
- Other Activities

Philips completed the sale of its Semiconductors division on September 29, 2006.

This report includes selected information on the financial performance of the Philips Group. The consolidated financial statements in the *Philips Annual Report 2006* and the information derived for this report are prepared in accordance with generally accepted accounting principles in the United States (US GAAP).

Following the sale of the Semiconductors division, the financial data from previous years have been restated to present the Semiconductors division activities as a discontinued operation for all periods presented in the *Philips Annual Report 2006*. For full understanding of the financial performance, please refer to the *Philips Annual Report 2006*.

Environmental results are limited to production activities for those manufacturing sites with more than 50 industrial employees.

For the year 2006, Semiconductors results are not integrated in the Philips Group totals, following the reporting principles for environmental reporting.

Philips is involved in various key ventures and participations, such as LG.Philips LCD. The activities of these operations are not consolidated in Philips Group data and are, therefore, not included in this report.

Auditor policy

The company maintains a policy of auditor independence, and this policy restricts the use of its auditing firm for non-audit services, in line with the US Securities and Exchange Commission rules under which the appointed external auditor must be independent of the company both in fact and in appearance. The policy is laid down in the comprehensive policy on auditor independence published on the company's website.

External assurance

Our print report has been externally assured by KPMG, in line with previous reports. Their non-financial assurance engagement, which was conducted in accordance with the International Standard on Assurance Engagements ISAE 3000, covers all of the information in the report, both quantitative and qualitative. KPMG's Assurance Report, which describes the work undertaken and their conclusions, is on page 70.

Assurance assignment

We have asked KPMG to review the print *Philips Sustainability Report 2006* to provide readers with a reasonable level of assurance on selected financial data, and a limited level of assurance on selected environmental data and other information. The report, including the identification of material issues, is our responsibility. Based on the defined scope, KPMG decided to perform the activities described in their assurance report.

We are in the process of reassessing the scope and depth of the assurance assignment to optimize the added value of the assurance process for our stakeholders and its contribution to internal improvements, particularly in light of the divestment of our Semiconductors division.

Assurance report

To the readers of the Philips Sustainability Report 2006

Introduction

We have been engaged by Royal Philips Electronics (Philips) to review the Philips Sustainability Report 2006 (further referred to as The Report). The Report is the responsibility of the company's management. Our responsibility is to issue an assurance report on The Report.

Context and scope

In The Report Philips describes its efforts and progress in relation to sustainability and reporting. Our engagement was designed to provide the readers of The Report with:

reasonable assurance on whether

- the data on financial performance, as specified in the section "Work undertaken and conclusions" are properly derived from the 2006 financial statements of Royal Philips Electronics;

limited assurance on whether:

- the data on total energy consumption and total direct CO₂ emissions for the years 2002 to 2006 are reliable;
- the other information in The Report is fairly stated.

Standards and criteria

We conducted our engagement in accordance with the International Standard on Assurance Engagements (ISAE 3000): "Assurance Engagements other than Audits or Reviews of Historical Financial Information", issued by the International Auditing and Assurance Standards Board. Amongst others this standard requires that:

- the assurance team members possess the specific knowledge, skills and professional competencies needed to understand and review the information in The Report, and that they comply with the requirements of the IFAC Code of Ethics for Professional Accountants to ensure their independence;
- when providing limited assurance, which is a lower level than reasonable assurance, a negative form of conclusion is used.

There are no generally accepted standards for reporting sustainability performance. Philips applies its own internal sustainability performance reporting criteria, derived from the Sustainability Reporting Guidelines of the Global Reporting Initiative and internal corporate guidelines for HSE reporting, as detailed on page 71 of The Report.

Considerations and limitations

Environmental, health, safety and social performance data are subject to inherent limitations given their nature and the methods used for determining, calculating and estimating such data. It is important to view the performance data in the context of the explanatory information provided on page 71.

To obtain a thorough understanding of the financial results and financial position of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics'), the reader should consult the Philips audited Financial Statements for the year ended 31 December 2006.

Work undertaken and conclusions

Environmental data

For the reliability of the data on total energy consumption and, total direct CO₂ emissions we conducted:

- visits to 10 reporting organizations in Europe, Asia and North America to review systems and data;

- reviews of:
 - the data reported by all EcoVision reporting organizations;
 - the data validation processes at corporate and product division level;
 - the calculations made at corporate level;
 - the data trends in discussions with management;
 - the changes in the data management systems for the reporting organizations that were visited in the previous three years; and
 - the systems used to generate, aggregate and report these data.

Based on the above, the data on total energy consumption and total direct CO₂ emissions for the years 2002 to 2006 do not appear to be unreliable.

Financial data

We have reconciled the data on financial performance in the sections of the Sustainability Report 2006 listed below, with the audited 2006 Group financial statements of Royal Philips Electronics.

- The section "Financial highlights 2006" on page 7;
- The section "Our economic performance", excluding the graph "Wage bill per geographic area in 2006".

Based on the above, the data on financial performance, as specified above are properly derived from the 2006 Group financial statements of Royal Philips Electronics, for which the independent auditors issued an unqualified audit opinion.

Other information

For the other information in the report we conducted:

- a review of the systems and processes used to generate this information;
- a review of internal documentation and intranet sources;
- interviews with staff for the information on Green Flagships, General Business Principles, Energy efficiency, Stakeholder engagement, Diversity and Inclusion and Supply chain.

Following our review we discussed changes to the draft Report with Philips, and reviewed the final version of The Report to ensure that it reflected our findings.

Based on the above, the other information in The Report does not appear to be unfairly stated.

Commentary

Without affecting the conclusions presented above, we would like to draw readers' attention to the following:

By providing more detailed information about supply management in this sustainability report and introducing the feature sections on "The energy challenge", "Healthcare solutions" and "Supporting development" Philips has made further progress in attuning its sustainability reporting to the developments in sustainability management and the information needs of its stakeholders.

Philips advocates that embedding sustainability in its core business processes throughout its operations creates value. We therefore recommend Philips to monitor this integration process and the value it creates systematically and disclose the results in future sustainability reports or other forms of communication.

Amstelveen, February 13, 2007.

KPMG Sustainability B.V.

Explanatory notes

Reporting standards

All reporting instructions, including definitions, procedures, calculation methods, etc., are available on our website www.philips.com/sustainability

Information sources

The major source for the statistics included in the special feature reports titled "Healthcare solutions" and "Supporting development" is the World Health Organization.

Health and safety

Basis for reporting

Data are reported on a monthly basis and validated on a quarterly basis.

Accounting for organizational changes

Data for new reporting organizations that started reporting in the current reporting year are added to the divisional and thus company totals in the first quarter they are consolidated.

Data for reporting organizations that were divested in the current reporting year are taken out of the divisional and thus company totals in the first quarter they are deconsolidated.

Comparability

The Semiconductors division is excluded from the year totals for the Philips Group in both 2005 and 2006.

Completeness

Data reported over 2006 cover 85% of the total number of Philips' FTEs. We aim for 100%. The difference can be explained by:

- Non-reporting of Medquist in the US
- Newly consolidated organizations not yet reporting Lumileds, Lifeline Systems, Avent Holdings, Intermagnetics
- Some non-reporting organizations in the Netherlands
- A number of small units.

In the US, maternity leave was not included in the Lost Work Time rate through 2005. From 2006 onward, maternity leave is required to be included.

Environmental performance

Environmental reporting standard

All reporting instructions, including definitions, procedures, calculation methods, etc., are included in the web-based EcoVision reporting and validation system. A reporting manual is available on our external website.

Basis for reporting

The environmental data in this report have been provided by our environmental reporting organizations. The following consolidation criteria have been applied:

- The starting point is the total of the consolidated Philips activities, as used for the reporting of the financial performance provided in the Philips Annual Report 2006. Environmental data are reported by each manufacturing activity owned, rented or leased and managed by Royal Philips Electronics, with 50 or more people working in production, and which is consolidated for financial reporting by Royal Philips Electronics.

Accounting for organizational changes

In order to provide a basis for calculating comparable changes at aggregated levels – such as divisional, regional or company level – for a reporting year versus a reference year, the structure of reporting organizations in previous years has to be made comparable with that of the reporting year. To do that, we apply the

following principles:

- Absolute data for new reporting organizations that started reporting in the current reporting year are added to the divisional and thus company totals of the previous years, with the same absolute figures per parameter as reported in the current reporting year.
- Absolute data for reporting organizations that were divested in the current reporting year are taken out of the divisional and thus company totals for the full current year.

Organizational changes in 2006

Data reported in previous years can change as a result of changes in Philips portfolio of businesses. Changes in 2006 were:

- Semiconductors
 - The Semiconductors division was divested on September 29, 2006
- Consumer Electronics
 - Shenzhen Audio no longer reports because manufacturing is outsourced to a third party
 - Business units Mobile Phones and Personal Infotainment were disposed of or assimilated into other Businesses
- Lighting
 - Calcutta, Juarez Lamps, Kahoku and Queretero were sold or closed, and Weert was exempt from reporting because of imminent closure in 2007
- Other Activities
 - Philips Enabling Technologies factories in Eindhoven, Singapore and Suzhou were divested, as were the Optical Storage factories in Szekesfehervar and Dendermonde, along with Anteryon in Eindhoven.

Accuracy

The conversion factors used for direct energy and restricted substances are unchanged from 2005.

We will update our software and reporting manual to reflect changes resulting from information in "Climate Change 2007," the Intergovernmental Panel on Climate Change (IPCC) 4th Assessment Report, published in February 2007.

Completeness

All 100 reporting organizations reported on time. One site was omitted from the report, but the influence of the missing data on corporate level is negligible.

Furnaces at Lighting production sites produce direct CO₂ emissions due to the decarbonization of dolomite and Na₂CO₃. These emissions have not yet been included in our reporting. We have estimated that they represent between 5% and 8% of total CO₂ emissions. We will adjust our reporting systems in 2007 to include these emissions.

Comparability







The reference year for the EcoVision III program is 2005, therefore no data changes are applicable for the years 2002-2004.

Overview Green Flagships 2006

Better environmental performance than chosen reference on Green Focal Areas (GFAs)

Division	Product group	Product type number	Energy consumption	Packaging	Hazardous substances	Weight	Recycling and disposal	Lifetime reliability	Notes
Medical Systems	Ultrasound Transducer	V8-4	●			●		N.A.*	
	MRI Scanner	Achieva 1.5T Release 2MRI Scanner	●			●		N.A.	
	SPECT Camera	BrightView Nuclear Medicine SPECT Camera	●		●	●		N.A.	
Consumer Electronics	42" LCD TV	42PF9730	●	●				N.A.	
	42" LCD TV	42PF7621D/10	●					N.A.	
	32" LCD TV	32PF9531/10	●					N.A.	
	32" LCD TV	32PF9531/98	●					N.A.	
	42" LCD TV	42PF9731D/37	●					N.A.	
	29" real flat TV	29PT8865	●	●				N.A.	
	32" LCD TV	32PF5321/12	●	●				N.A.	
	32" LCD TV	32PF7321/93	●	●				N.A.	
	1GB audio player	SA9100	●			●		N.A.	
	VGA CMOS Webcam	SPC610NC	●	●		●		N.A.	
	Mobile phone	CT1898	●					N.A.	
	Mobile phone	CT7568	●	●		●		N.A.	
Lighting	Lighting Electronics	Actilume	●		●			●	
	Lamp	TL-D 90 DE LUXE	●		●				
	Lamp	TL-D 90 Graphica			●				
	Lamp	TL-D FOOD			●				
	Lamp	TL-D FOOD SECURA			●			●	
	Lamp	TL-D ActiViva Natural			●				
	Lamp	TL-D Optiview	●		●			●	
	Lamp	TL-D SUPER 80HF			●				
	Lamp	TL-D REFLEX SUPER 80			●				
	Lamp	TL-D SECURA SUPER 80			●				
	Lamp	TL-D Xtra Secura Super 80			●			●	
	Lamp	TL-D Xtreme Secura Super 80			●				
	Lamp	TL5 HO ActiViva Natural	●		●				
	Lamp	TL5 HO ActiViva Active	●		●				
	Lamp	TL5 HO 90 Deluxe			●				
	Lamp	TL5 HO Optiview			●				
	Lamp	MASTER PL Electronic PRO			●				
	Lamp	PL-S 2p/4p			●				
	Lamp	PL-L Xtra						●	1
	Lamp	PL-T Xtra						●	1
	Lamp	PL-C Xtra						●	1
	Lamp	MASTER PL Electronic			●			●	
	Lamp	MASTER PL Polar Electronic			●			●	

Better environmental performance than chosen reference
on Green Focal Areas (GFAs)

Division	Product group	Product type number	Energy consumption 	Packaging 	Hazardous substances 	Weight 	Recycling and disposal 	Lifetime reliability 	Notes
Lighting	Lamp	MASTER Electronic Dimmable			●			●	
	Lamp	MASTER PL E Automatic			●			●	
	Lamp	SL E-PRO	●					●	2
	Lamp	AMBIANCE PRO			●			●	
	Lamp	MASTER PAR E	●					●	
	Lamp	MASTER CLASSIC	●					●	
	SSL	LED Freezer Lighting Affinium	●		●			●	
	Luminaires	Fiorenza MMC Luminaire	●						
	Luminaires	Magneos Luminaire	●	●		●			
	Luminaires	Celino	●		●	●			
	Luminaires	TCX500	●		●	●			
	SPL	CST-250HR	●	●				●	2
	SPL	BLB-TL-D 36&40W			●				
	SPL	BLB-TL 6W			●				
	SPL	BLB-PL-S 9W			●				
	Lamp	TL- T8 16W EcoMaster (LATAM)			●			●	
	Lamp	TL- T8 32W EcoMaster (LATAM)	●		●			●	
	Lamp	CDM R111Aluline 111	●					●	2
	Lamp	MASTERLINE ES						●	
	Lamp	POLAR Starter			●			●	

* N.A.: Not Applicable

1. This Green Flagship product does have an initial higher amount of Mercury (Hg) than its chosen reference. To compare a long life product with its reference product, the amount of mercury dosed in relation to the light output per burning hour over the total product lifetime is calculated. This expression enables a relative comparison to prove environmental performance over the product lifetime and shows a relative better environmental performance for this product compared with its reference product.
2. This Green Flagship product is compared with an application in which currently halogen lamps are being used. Increased environmental performance in terms of energy efficiency and lifetime reliability in combination with the possible lowest amount of Mercury needed.

Glossary

CFC	Chlorofluorocarbon – CFCs are considered deleterious to the ozone layer.	IPCC	The Intergovernmental Panel on Climate Change – established by the World Meteorological Association (WMO) and United Nations Environment Programme (UNEP) to assess scientific, technical and socio-economic information relevant for the understanding of climate change, its potential impacts and options for adaptation and mitigation. www.ipcc.ch
CO ₂	Carbon dioxide – The most prevalent greenhouse gas.	ISO 14001	Formulated by the International Standardization Organization (ISO) this standard forms the basis for setting up, auditing and certifying Environmental Management Systems. www.iso.org
CT	Computed tomography – A special radiographic technique that uses a computer to assimilate multiple X-ray images into a two-dimensional cross-sectional image.	KPI	Key Performance Indicator – financial and non-financial metrics used to quantify objectives to reflect strategic performance of an organization.
C-TRAIN	The so-called “C-TRAIN” research center aims to invent a host of new medical treatments using nanotechnology. The center – officially called the Washington University Consortium for Translational Research in Advanced Imaging and Nanomedicine – is based in a St. Louis research incubator called Cortex, located near Washington University’s medical school in St. Louis, Missouri, US.	MDG	United Nations Millennium Development Goals – eight goals to address poverty-related issues by 2015, the MDGs form a blueprint agreed to by all the world’s countries and all the world’s leading development institutions. www.un.org/millenniumgoals/
EICC	The Electronic Industry Code of Conduct identifies appropriate standards of conduct for socially responsible entities operating in the electronics industry. www.eicc.info	NGO	Non-governmental organization – A not-for-profit organization that pursues an issue or issues of interest to its members by lobbying, persuasion and/or direct action.
Environmental Management System	Part of an organization’s general management system, an environmental management system makes it possible to formulate clear goals for environmental work, systematic follow-up of results and documentation of practices and activities.	ORET	Development-Related Export Transactions Programme (ORET) – ORET is a grant program of the Directorate-General for International Cooperation of the Dutch Ministry of Foreign Affairs. Its objectives are to promote sustainable economic development and improve the business climate in developing countries by facilitating investment in their economic and social infrastructure.
EU	European Union – Formerly known as European Community or European Economic Community, this is a union of 27 independent states based on the European Communities and founded to enhance political, economic and social co-operation. europa.eu	PET	Positron emission tomography – A highly specialized imaging technique that uses short-lived radioactive substances to produce three-dimensional colored images of those substances functioning within the body.
FTE	Full-time equivalent – A figure calculated from the number of full-time and part-time employees in an organization that represents these workers as a comparable number of full-time employees.	PJ	Petajoule – The Joule (J) is the basic energy unit of the International System of Units (SI). It is ultimately defined in terms of the meter, kilogram and second. Peta is the metric prefix indicating 10 ¹⁵ times base unit (1 followed by 15 zeros).
GDP	Gross Domestic Product – represents the total market value of all final goods and services produced in a country in a given year.	Sustainable Development	This concept was first conceived in 1987 by Gro Harlem Brundtland, the premier of Norway, who led the World Commission on Environment and Development. Its report, titled <i>Our Common Future</i> , defined Sustainable Development as “meeting the needs of the present generation without compromising the ability of future generations to meet their own needs.”
GJ	Gigajoule – The joule (J) is the basic energy unit of the International System of Units (SI). It is ultimately defined in terms of the meter, kilogram and second. Giga is the metric prefix indicating 10 ⁹ times base unit (1 followed by 9 zeros).	Terre des Hommes	Terre des Hommes is a child rights organization that helps organizations in developing countries. www.tdh.nl
Global warming	The gradual increase of the temperature of the earth’s lower atmosphere as a result of the increase in greenhouse gases since the Industrial Revolution. Sustained increase causes climatic changes.	UN	United Nations – Established in 1945, the purposes of the United Nations, as set forth in its Charter, are to maintain international peace and security; to develop friendly relations among nations; to cooperate in solving international economic, social, cultural and humanitarian problems and in promoting respect for human rights and fundamental freedoms; and to be a centre for harmonizing the actions of nations in attaining these ends. www.un.org
GRI	Global Reporting Initiative – A worldwide, multi-stakeholder network the GRI’s vision is that reporting on economic, environmental and social performance by all organizations is as routine and comparable as financial reporting. www.globalreporting.org	UNCTAD	United Nations Conference on Trade and Development – Established in 1964, UNCTAD promotes the development-friendly integration of developing countries into the world economy. www.unctad.org
HCFC	Chlorofluorocarbon containing one or more hydrogen atoms. HCFCs are an alternative to CFCs, with approximately one-tenth of their ozone-depleting properties and greenhouse effect.	US GAAP	United States Generally Accepted Accounting Principles
IFC	International Finance Corporation – the private sector arm of the World Bank Group (see World Bank below). Its mission is to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people’s lives. www.ifc.org	WB/CSD	The World Business Council for Sustainable Development is a CEO-led, global association of some 190 companies dealing exclusively with business and sustainable development. www.wbcsd.org
		WHO	World Health Organization – The United Nations specialized agency for health, established in 1948. WHO’s objective, as set out in its Constitution, is the attainment by all peoples of the highest possible level of health. www.who.int
		World Bank	The World Bank provides financial and technical assistance to developing countries. It is comprised of two unique development institutions owned by 185 member countries – the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). www.worldbank.org

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