



The world's entire production of small-signal transistors and power transistors (120 billion pieces) can be contained on one 300 mm semiconductor wafer.

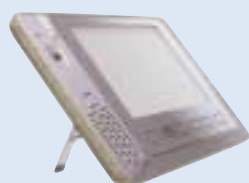
In Philips' R&D labs more than 20 inventions are made every day.



Philips has developed a technology that makes it possible to 'paint' a display on any carrier.



Philips generates more than 10 patents every day.



#### 'Safe Harbor' Statement under the Private Securities Litigation Reform Act of 1995

This document contains certain forward-looking statements with respect to the financial condition, results of operations and business of Philips and certain of the plans and objectives of Philips with respect to these items (including, but not limited to, cost savings), in particular the outlook paragraph of the 'Report on the performance of the Philips Group' in this 'Management Report' booklet. 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. These factors include, but are not limited to, levels of consumer and business spending in major economies, changes in consumer tastes and preferences, changes in law, the performance of the financial markets, pension costs, the levels of marketing and promotional expenditures by Philips and its competitors, raw materials and employee costs, changes in future exchange and interest rates (in particular changes in the euro and the US dollar can materially affect results), changes in tax rates and future business combinations, acquisitions or dispositions and the rate of technological changes.

Market share estimates contained in this report 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.

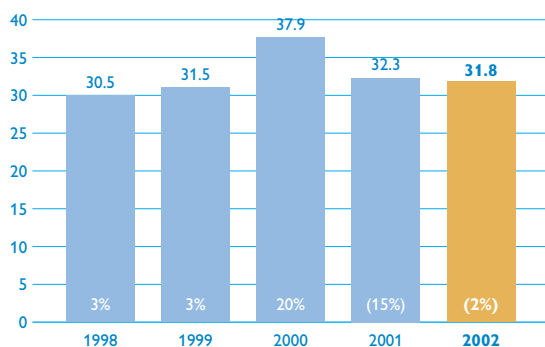
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This Management Report and the separate booklet entitled 'Financial Statements and Analysis' together comprise the full Annual Report for the year 2002 of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics'). This Management Report comprises a summary of the Operating and Financial Review and Prospects entitled 'Report on the Performance of the Philips Group'. The selected financial information included in this Management Report is derived from the Philips Group's full annual financial statements including notes. The Financial Statements and Analysis booklet also contains additional financial information and further statutory and other information. For a full understanding of the results of the Group and the state of affairs, both booklets should be consulted.

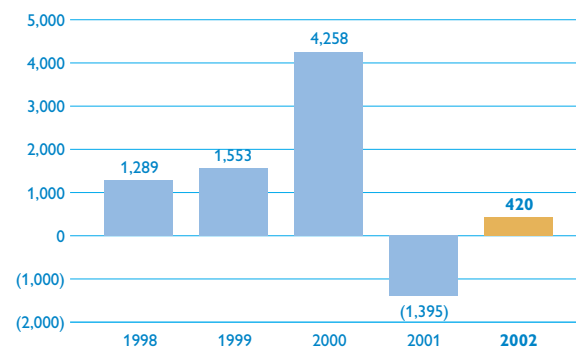
## Sales

in billions of euros and % growth



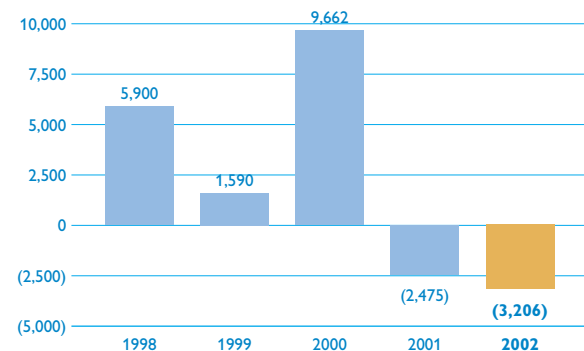
## Income (loss) from operations

in millions of euros



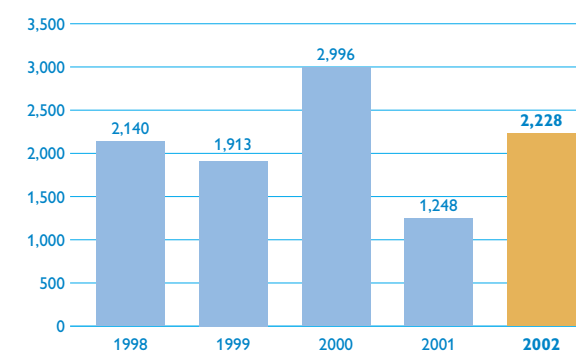
## Net income (loss)

in millions of euros



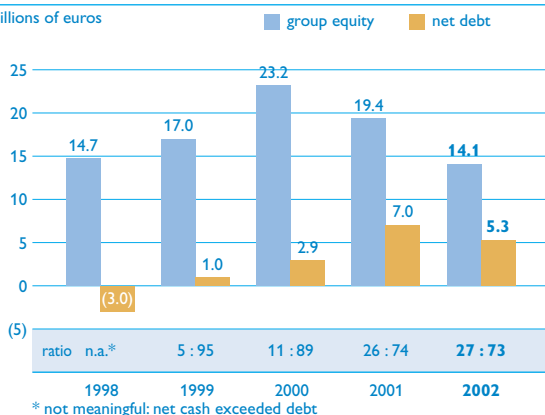
## Cash flows from operating activities

in millions of euros



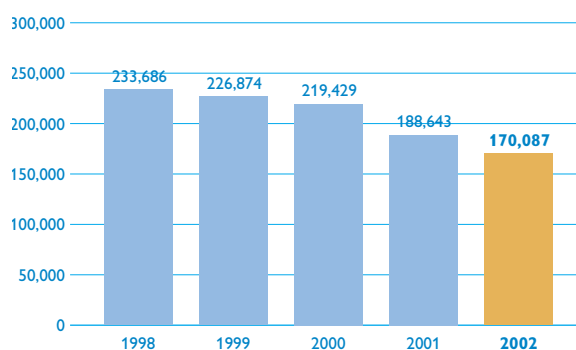
## Net debt to group equity

in billions of euros



## Employees

number at year-end



## Financial highlights

all amounts in millions of euros unless otherwise stated

	2002	2001
Sales	31,820	32,339
Income (loss) from operations	420	(1,395 )
As a % of sales	1.3	(4.3 )
As a % of net operating capital (RONA)	3.2	(9.3 )
Net income (loss)	(3,206 )	(2,475 )
Per common share - basic	(2.51 )	(1.94 )
- diluted	(2.51 )	(1.94 )
Dividend paid per common share in euros (related to prior financial year)	0.36	0.36
Cash flows before financing activities	1,980	(3,316 )
Stockholders' equity	13,919	19,160
Per common share	10.91	15.04
Net debt : group equity	27:73	26:74
Employees	170,087	188,643
Excluding special items*:		
Income (loss) from operations	460	(160 )
As a % of sales	1.4	(0.5 )
As a % of net operating capital (RONA)	3.5	(1.1 )
Net income (loss)	208	(779 )

Philips has applied US GAAP in its reporting from January 1, 2002 onwards. Previous periods have been restated accordingly.

\* Special items relate to income and expenses resulting from business operations, which, because of their nature, are disclosed separately to give a better understanding of the underlying result for the period. Special items include items such as restructuring and impairment charges, acquisition-related charges and gains and losses on the disposal of businesses or participations and real estate. However, the reader should note that net income excluding special items is not a measure of financial performance as defined by US GAAP or Dutch GAAP.

## Message from the President

Dear shareholder,

Philips had to contend with a very difficult operating environment in 2002. Nevertheless, we made definite advances in most areas of our business that we *can* control – by simplifying our organization and driving down costs, improving the quality and cycle time of our operational processes, lowering inventories and reducing debt.

With sales virtually flat, this has resulted in income from operations of EUR 420 million and a very strong operational cash flow of over EUR 2.2 billion. Our net income, however, was heavily impacted by non-cash impairment charges of over EUR 3.2 billion that we took in respect of securities (Vivendi Universal) and equity investments (LG.Philips Displays and Atos Origin).

Looking at our individual businesses, our consumer and professional divisions did particularly well. Domestic Appliances and Personal Care (DAP) achieved good growth and record profits, demonstrating innovative marketing and product leadership. We also delivered on our promise to tackle the problems at Consumer Electronics by intensifying our customer and market focus. We are encouraged by the progress that has been made in the United States, where the actions to establish Philips as a premium brand are beginning to show early signs of success, while in Europe we were able to regain the No. 1 position in the industry.

Despite tough market conditions, Lighting outpaced the competition, maintaining strong margins through continued innovation and customer focus. Medical Systems implemented a demanding integration plan and is well positioned for growth following a number of new product introductions.

Weaknesses persisted in our Components and Semiconductors divisions, requiring us to take drastic measures. We dissolved Components and repositioned its respective businesses, changing the business model to improve profitability. At Semiconductors, while maintaining the focus on product innovation, we addressed the unaffordably high cost structure with a number of measures, including the planned closure of the Albuquerque facility at the end of 2003.



Our drive for change is based upon a management framework that comprises five key elements – financial strength, portfolio management, organizational effectiveness, customer intimacy and product & technology momentum. I will now review our progress in each of these areas for you.

### **Financial strength**

To achieve our longer-term objectives we are committed to maintaining a strong balance sheet. In the course of 2002 we reduced our net debt by EUR 1,725 million while maintaining a debt-to-invested-capital ratio of better than 30:70, despite heavy impairment and restructuring charges. Debt reduction will continue to be high on our agenda for 2003 as we value the access we have to the capital markets and will do everything within our power to safeguard it.

### **Portfolio management**

In 2002 we made significant progress in bringing our portfolio in line with our ambitions, in terms of market share, profitability and growth potential.

We are well on track with our divestment program. Of the low-growth low-return businesses earmarked by us, 16 have been divested. In 2002 we also carried out a comprehensive review of our Components division. This led to the dissolution of the division and a restructuring program to bring Philips Optical Storage back to profitability. The new organizational structure, which became effective on January 1, 2003, will streamline innovation and create more value through alignment of related businesses previously grouped in different divisions.

At Semiconductors, despite very difficult market conditions, we have continued to invest in innovation and R&D to drive future growth, and in 2002 we made a few add-on acquisitions to strengthen our product portfolio. We also concluded a landmark partnership with STMicroelectronics, Motorola and TSMC to develop 300 mm technology through a joint venture in Crolles (France).

We strengthened our patent and licensing position in the field of Digital Rights Management (DRM) by acquiring Intertrust together with Sony and other investors.

### **Building a more effective organization**

A key element of our drive to create a better, simpler, faster and more cost-effective organization is our program *Transforming into One Philips* (TOP). It is designed to streamline our business support functions by standardizing processes and introducing a shared way of working in the areas of IT, HRM, Finance and Purchasing.

In 2002 this approach enabled us to reduce overhead costs by EUR 257 million. We intend to increase our total savings to EUR 1 billion by the end of 2003; this figure will include the post-merger integration savings at Medical Systems and the savings delivered by other initiatives to reduce indirect costs.

TOP is not just a method of cost control. It is our vehicle for fundamental and lasting change in the way we operate this company – a simpler organization, with greater transparency and clearly defined accountabilities. The move to shared services means that the businesses will be able to focus on the real value drivers – technology, design and marketing – which will enhance our ability to innovate. With the successful implementation of TOP, we will have a 'plug and play' support infrastructure, allowing new businesses to be launched quickly and easily.

### **Customer intimacy and product & technology momentum – the drivers of growth**

We made good progress in making our organization leaner and more agile. However, that is not enough. *Real business successes* come from getting close to our customers and understanding what they want. Here too we can report a number of successes in 2002.

In March we signed a 5-year USD 5 billion global strategic alliance with Dell, making us a preferred partner for the supply of computer peripherals to Dell.



In May our Lighting division won an exclusive 5-year contract for the supply of lamps to Home Depot, the world's largest home-improvement retailer. We were able to capture this deal – which has made Philips the *only* branded light bulb supplier to Home Depot – by demonstrating an understanding of both Home Depot's requirements and the needs of the consumer.

Our focus on customer requirements also resulted in a series of important technological design wins in 2002: many of the world's top electronics brands are now using Philips Semiconductors' Nexperia platform, and our Mobile Display Systems business realized major color-screen design wins for handsets produced by some of the world's leading mobile phone manufacturers.

In September we launched, together with Nike, a range of stunning portable sports audio products, underscoring how the impact of customer-focused technology can be maximized through co-branding and co-marketing.

The launch of the new Sonicare toothbrush, our fastest-growing product, provides a further illustration of what can be achieved by combining customer insight and product and technology innovation.

The successful introduction of the DVD+RW and the PixelPlus TV range shows that we understand what customers value, and that such an understanding can lead to strong market share gains.

### **The way forward – one company, one brand, one culture**

In 2002 we devoted considerable energy to establishing our vision of who we are and where we're going. Besides the portfolio adjustments and cost-base reductions outlined above, this involved strengthening the Philips brand and taking tougher steps to create a single, unified company.

Early in the year, we identified our mission as being *to enhance the quality of life for all our customers by providing them with meaningful technological innovations at the right time*. In the deepest sense, we see our business as *technology for people*. In doing so, we are focusing on the application areas of lighting, entertainment, communication, personal care and healthcare, leveraging our core competencies in digital technologies, specifically displays, optical storage, wireless connectivity and digital video.

And in 'ambient intelligence' – the application of interconnected, anticipatory and responsive technologies distributed throughout the home, the workplace, etc. – we saw the context for an effective, meaningful convergence of these technologies and at the same time the driving force for Philips *as one company*.

Working together for a common goal is also a question of personal commitment. That's why we are placing strong emphasis on our company values: *Delight customers, Deliver on commitments, Develop people* and *Depend on each other*. 'Living' these values will form a significant part of employee performance appraisals in our new People Performance Management system. This has already been applied in the appraisal process for the top 1,000 managers within the Company and is now being cascaded down, so that the system is fully embedded in the organization by the end of 2003.

### **Looking ahead**

In all these ways, we are moving to establish the basis for long-term margin expansion and growth – work that will continue in 2003.

Given the uncertain outlook for the economy we are directing our efforts primarily towards cash flow generation and economic profit.



For the year 2003 our agenda is to:

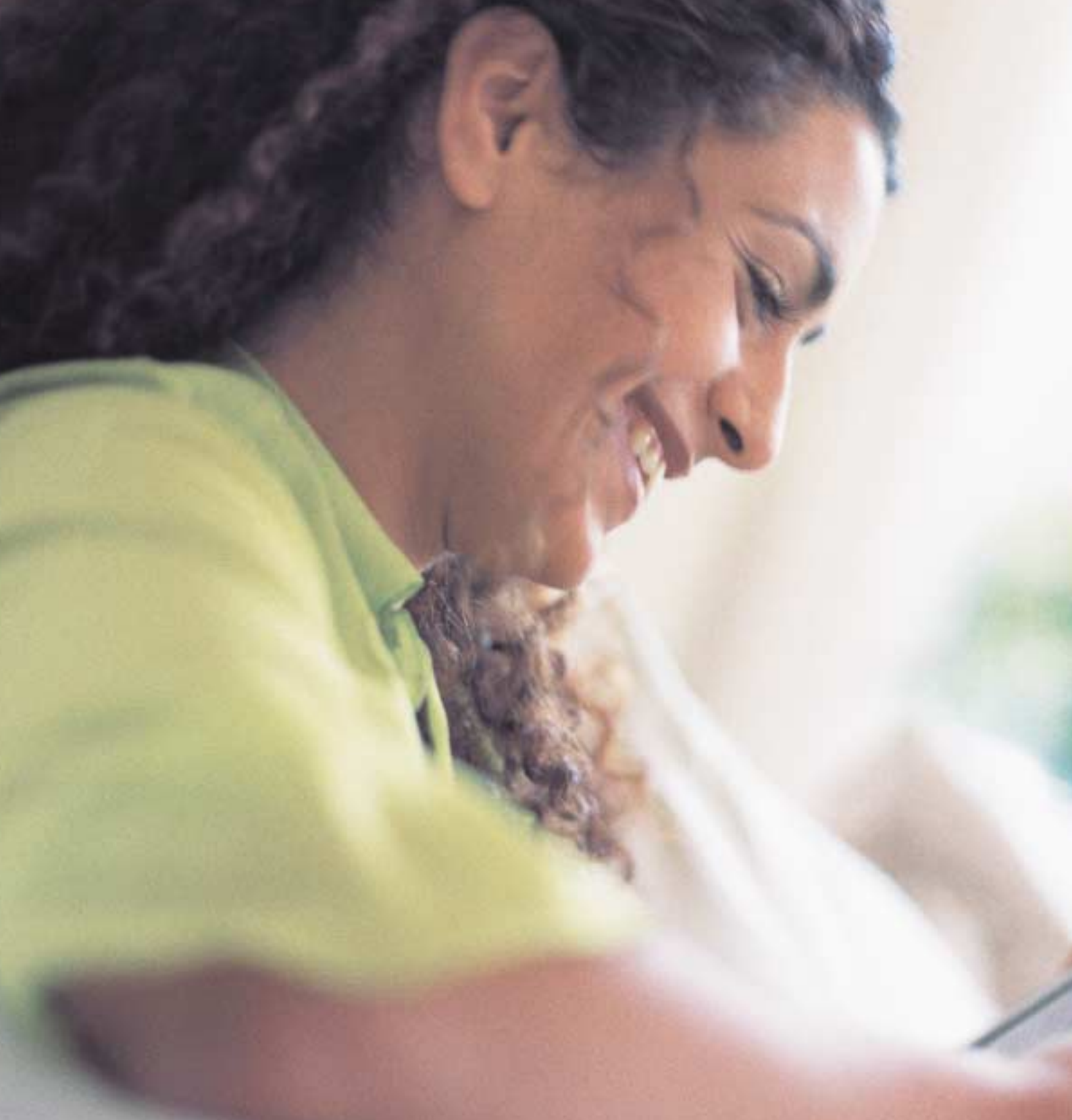
- complete the TOP program
- achieve the cost-saving target of EUR 1 billion
- restore Semiconductors to profitability by lowering the break-even point
- bring Consumer Electronics in the USA to full profitability from the fourth quarter onward
- move Medical Systems forward to achieve 14% EBITA in 2004
- make Philips a truly market-driven company.

Consistent with our Long-Term Incentive Plan, we are targeting, with these initiatives, a Total Shareholder Return (TSR) that is in the top quintile of our defined peer group of 24 companies.

In conclusion, I would like to thank you, our shareholders, for the confidence you have continued to show in the Company. I would also like to express my thanks to all our employees throughout the world for their efforts over the past year. Also on behalf of my colleagues on the Board of Management, I can assure you that we are committed to delivering solid financial performance and continued product and market leadership in the years to come.

A handwritten signature in black ink, appearing to read 'G. Kleisterlee', with a stylized flourish at the end.

Gerard Kleisterlee, *President*



#### **Lighting**

- Lamps
- Luminaires
- Lighting Electronics
- Automotive & Special Lighting



#### **Consumer Electronics**

- CE (TV, audio, VCR, DVD, monitors, GSM, set-top boxes, remote control systems, etc.)
- Licenses



#### **Domestic Appliances and Personal Care**

- Shaving & Beauty
- Oral Healthcare
- Food & Beverage
- Home Environment Care

We want to be perceived as an innovative company that truly enhances the quality of life – a company that conducts business in a responsible and sustainable manner, with delighted customers, motivated employees and satisfied shareholders.

For over 100 years, since its founding as a manufacturer of incandescent lamps and other electrical products in 1891, Philips has been leading the way, setting new standards and pushing technology to new heights. Throughout the 20th century Philips continued to improve people's lives with pioneering innovations, e.g. in the fields of television, medical X-ray, transistors, integrated circuits and optical technology. And today, in the digital era, we are committed to building upon this heritage to make things better for people all over the world.

Few companies touch as many lives, in as many different ways, as we do. True to our heritage, we will use our understanding of how people experience technology to provide them with innovations that enrich their lives at home, at work and on the move. Driven on by a shared understanding of the Philips brand and what it stands for, we will harness the passion and capability for innovation across the company by empowering our employees, encouraging cooperation and fostering value-adding relationships with our suppliers.

In 2002 we embarked a comprehensive change program – TOP, *Transforming into One Philips* – with the aim of building a better, simpler, faster and more cost-effective organization. A company of many parts acting as one. TOP is all about designing and implementing new ways of working together and sharing resources, e.g. by standardizing many services (IT, Purchasing, HRM, Finance). Besides the obvious financial benefits that this delivers, it allows business managements to concentrate their energies fully on the real value drivers – innovation, technology, design, marketing – and to foster the spirit of collaboration required to unlock the full potential of the Philips brand.



#### **Semiconductors**

- MultiMarket Semiconductors
- Digital Consumer Systems
- Display Solutions
- Mainstream Consumer Systems
- Mobile Communications
- Networking
- Identification
- Mobile Display Systems



#### **Medical Systems**

- X-ray Equipment
- Computed Tomography
- Magnetic Resonance
- Ultrasound
- Nuclear Medicine
- Imaging IT
- Cardiac and Monitoring Systems



#### **Technology & Design**

- Philips Research
- Intellectual Property & Standards
- Centre for Industrial Technology
- Philips Design
- Corporate Investments
- Optical Storage



As we turn to face the challenges that lie ahead, it is also important to celebrate the successes we achieved in 2002.







#### **Milestone contract**

In 2002 Philips Lighting secured the biggest deal in its history: a long-term contract to be the exclusive supplier of branded lighting products to the US-based company Home Depot, the world's leading home-improvement retailer. This alliance illustrates how Philips Lighting's focus on marketing, innovation and delivery reliability is creating new opportunities with its leading global customers.

#### **Recognition for sustained contribution**

Further underlining our achievements in the TV domain, Philips received the prestigious *Technological/Engineering Emmy Award* for its 'lifelong contribution' to the development and commercialization of widescreen television.

#### **Excellence in design**

In 2002 Philips Design received no fewer than 45 prestigious international awards, from, among others, iF (International Forum Design), the American CES 2002, the Hong Kong Designers Association and the Singapore Designers Association.

#### **Nexperia**

Philips Semiconductors' Nexperia Multimedia Solutions provide reconfigurable and re-usable solutions for full digital television. Indeed, three of the world's top five TV makers use Nexperia solutions in their digital TV products. Furthermore, over 70% of the world's DVD+RW recorders made in 2002 contained a Philips Nexperia solution.

#### **Top ratings**

In October 2002, market outlook reports issued by MD Buyline, an independent healthcare research company, gave top standings to our Medical Systems division. Setting an unprecedented record, Philips received the highest ratings in 15 out of 26 categories among eight medical technology companies, ranking number one in every modality that it offers. In December 2002, Medical Systems grabbed top honors for 'overall service performance' in eight different categories in IMV Limited's annual Service Track Imaging survey, the first company ever to do so for such a wide array of medical technology disciplines.

#### **Excellence in customer service**

Philips Advance, our Lighting Electronics business in North America, has been recognized as *Supplier of the Year* by three of North America's leading electrical distributor partners. Grainger, the leading supplier of maintenance, repair and operating products, presented Advance with their prestigious CFQ1 Award in July, as well as their elite *Supplier of the Year* award. In September, Advance was presented with the *2001-2002 Supplier of the Year* award by Affiliated Distributors, the largest network of independent electrical and industrial product distributors in North America. Then in October, it was recognized as *Supplier of the Year* by IMARK, North America's second-largest consortium of electrical distributors.

#### **Setting the standard**

With its proprietary PixelPlus technology Philips has set a new industry standard in TV picture quality. Impressive image-processing improvements have been achieved, bringing incredible sharpness, detail and depth to the TV picture. In recognition of this, the European Imaging and Sound Association (EISA) named our PixelPlus TV set 32PW9527 *European Television of the Year 2002-2003*. Our DVD Recorder DVDR890 also won an EISA Award.



#### HomeLab

In April 2002, Philips opened the HomeLab, a fully functional home built to help Philips researchers to better understand people's need for and use of technology, and to test Ambient Intelligence prototypes – interconnected, anticipatory and responsive technologies that make home/work life more convenient, efficient and enjoyable.

People interact with technology practically every second, often without even realizing. By appreciating how these interactions take place, we can enhance our customers' experience of them.



#### **iPronto – redesigning control of the digital home**

Enabling users to control home theater components, lighting, home networks, climate control and other IR/RF/Ethernet applications, the iPronto is set to revolutionize the connected digital home. Featuring a high-resolution LCD touchscreen, a customizable user interface and exterior hard buttons, the iPronto allows consumers to control their entire home at the touch of a button from anywhere in the building. Its upgradability allows users to personalize the interface with their own designs, icons downloaded from the Internet, etc.



#### **Vital technology**

In 2002 Philips received FDA clearance for its HeartStart Home Defibrillator for the treatment of sudden cardiac arrest. Published studies show that over 70% of arrests happen in the home and the majority of those are witnessed. The HeartStart – recognized as a *Best Product of 2002* by Business Week/USA Today – offers unrivaled ease of use for in-home responders with a range of abilities, a potentially significant gap in time between device training and first use, and a possibly stress-compounding emotional connection to the victim.



Our brand – the result of more than 100 years' investment in research and design, in technology, creativity and marketing – is what defines Philips as a company.







#### Who we are

The year 2002 saw the completion and roll-out of our Brand Foundation, the culmination of a long and exhaustive process of defining exactly what the Philips brand stands for; thus revitalizing our brand focus. To ensure a consistent, shared understanding of this brand focus, we disseminated the Philips Brand Book throughout the company. Besides articulating the underlying ethos of the Brand Foundation, the Brand Book also provides guidelines to be followed when giving expression to the Philips brand, for instance via sponsorship.



#### Heart for Sports

The Philips brand is reaching out to new audiences in a broad range of settings. For example under the *Heart for Sports* program, student athletes can undergo free heart screening by doctors using a Philips OptiGo hand-carried ultrasound system. Advance detection of potential problems helps to give every sports event a happy ending.



#### Living technology

The 'living technology' advertising campaign for Philips' semiconductor solutions is based on the premise that Philips improves the lives of consumers through the deployment of technology. Technology that is constantly evolving and growing with the needs of those consumers. The 'living technology' advertisements hold out the promise that the flexibility, innovation, future-proofness and speed-to-market offered by our semiconductor solutions will enable our customers to secure a competitive edge and grow their business.



#### **Winning alliance with Nike**

In March 2002 Philips and Nike announced a strategic alliance to merge their athletic and digital technology expertise to develop innovative audio/video sports products that create a richer, more motivating environment for physical activity. Both Nike and Philips bring unique strengths to the venture. The first range of Nike-Philips digital audio products, featuring solid-state MP3, MP3-CD and FM radio, was introduced in September 2002.



We have invested aggressively in marketing competence to achieve market leadership in key growth areas, capitalizing on the company's extensive portfolio of innovative technologies and bringing products to the market that capture the consumer's imagination.



#### Successful turnaround

The turnaround of Consumer Electronics' business in the key US market is proceeding with success, thanks to our intensified focus on product innovation and customer intimacy coupled with stronger brand and channel management. In 2002 this approach paid off with 142% sales growth in up-market retailers and 55% year-on-year growth in the branded TV segment. We also secured placement for our DVD Recorder in over 4,000 retail selling floors, both cases reflecting the successful development of Philips as a premium brand.



#### Die Another Day

The new James Bond film *Die Another Day* featured prominently in the advertising and promotional campaigns for Sensotec, the new Philishave electric shaver with Personal Comfort Control.

We are nurturing a spirit of passion and commitment to make change happen.





#### Winning combination

Liquid Crystal on Silicon (LCoS) technology is an essential element of future display devices, offering sublime picture quality – natural-looking colors and crystal-clear definition – in sleek designs at lower cost. The development of LCoS has been a cross-divisional effort involving Research, UHP Special Lighting, Semiconductors, the LCoS group, Creative Display Solutions and Consumer Electronics. With Philips holding all the basic patents, LCoS is a supreme example of how the businesses can work together to create a complete product, taking advantage of their unique – combined – ability to cover the entire value chain.



#### Team building

Through multicultural, multidisciplinary teams, Philips Medical Systems focuses on serving the needs of its customers worldwide. A host of projects are well under way to integrate the acquired companies into the organization, creating one effective team, facilitating cultural change and sharing best practices.



#### Human experiences

In 2002, Philips Design presented the results of a European Commission research project called Multiple Intimate Media Environments (MiME), which was carried out together with Xerox Research Centre and Nottingham University. MiME focuses on the relationship between computer technology and people's experience of their 'intimate media' – the things they use to store items that have personal meaning or value, such as photos, souvenirs and diaries. As computers move into every aspect of personal life, MiME proposes that instead of allowing intimate media to disappear into the computer, artefacts and systems should be designed to promote human experiences around the collection, storage and sharing of intimate media.



# Lighting

Philips Lighting is No.1 in the global lighting market. The division consists of four lines of business – Lamps, Luminaires, Lighting Electronics and Automotive & Special Lighting. Across Europe, North America, Latin America and Asia Pacific, Philips Lighting employs some 47,000 people.

*Our ambition is to achieve profitable growth in developing markets, in key accounts with leading global customers, in innovative new application segments and in our existing markets. Innovation, marketing excellence and customer service – specifically delivery reliability – are the three cornerstones of our business as it moves forward. Focusing on these areas at the same time as pursuing a policy of continuous improvement and strict control of costs and assets will confirm our leadership position as a pace-setter in the lighting industry.*



## Colorful enhancement

To enable people to see buildings in all their beauty without disturbing the atmosphere for those inside, Philips Lighting has created LEDline, a new concept to enhance the texture of walls with colored LEDs.

## Humanizing lighting

At Philips we are constantly asking ourselves how lighting can do more for people in their daily lives. How can it create the right atmosphere at home, in shops, offices, etc? How can it be used to have a positive effect on their moods and feelings? On their productivity? These questions are at the heart of our new consumer communication approach launched in 2002, which involves talking to consumers and developing an understanding of their needs and desires. This dialogue has prompted a shift in accent from selling *lighting* to selling *visual emotion*. Such 'humanization' of lighting reinforces the strength of our brand and, for our customers, enhances our value as a partner.

## Ground-breaking deal

In 2002 we announced the biggest deal in the history of Philips Lighting: a long-term contract to be the exclusive supplier of branded lighting products to Home Depot, the US company that is the world's leading home-improvement retailer. This alliance exemplifies how Philips Lighting's focus on marketing, innovation and delivery reliability is opening up new opportunities with its leading global customers.

## On the right road

People expect cars to have ever-higher levels of quality, reliability and design. Philips' HiPerVision car lamps represent a clear response to this trend. HiPerVision lamps last the lifetime of the car, use less energy, are recyclable and small, and offer greater design freedom. That's why major car producers like Mercedes, Audi, Volkswagen and Opel are already using this technology in some of their cars. HiPerVision – a new lighting concept developed by Philips using picture-tube technology to achieve an excellent sealing of the bulb – is ideal on the road when one needs to be seen.



### Dynamic light and color

Light-emitting diodes (LEDs) offer enormous potential for existing and new applications requiring dynamics in light level and color. Their small size, long life, instant response, increasingly powerful light output, durability and semiconductor-based nature set them apart from other lamp technologies. The Luxeon V LED has made it possible to create special color effects in shops, offices and the home. Luxeon technology provides a colorwash alternative that combines high light output with long lamp life, energy savings and other benefits of solid-state lighting. Luxeon V generates a record-shattering 120 lumens of light from a single emitter – by far the highest-power LED on the market. Philips Lighting, along with LumiLeds Lighting (our joint venture with Agilent Technologies), is spearheading this development.

### The power of cooperation

Virtually every aspect of life is being impacted by computers offering ever-rising performance levels at lower cost thanks to increasingly complex ICs. Further progress in IC technology is heavily dependent on new projection methods to etch the

finest details onto silicon. EUV (extreme ultraviolet), a radiation with a wavelength at around 13 nm, is the technology widely expected to revolutionize semiconductor lithography from about 2007.

In this area, collaboration is the key to achieving technological breakthroughs and bringing innovations to market in time. At the cutting edge of projection technology, Philips Lighting is combining its century-long experience in lighting innovation with the expertise of the Fraunhofer Institute in Germany and Philips Research's unique knowledge of light-giving plasma technology. In less than 15 months the output power of the EUV lamp was increased by a factor of nearly 20, and at the end of 2002 the company shipped the first prototype to its major customer and partner, ASML, clearly demonstrating how much can be achieved by working together.

### Natural rhythm of daylight

Recreating the natural rhythm of daylight can subtly enhance the atmosphere in a shop or office, putting people more at ease. Such dynamic light ambience is reality with Carpe Diem, Philips' spectacular new luminaire concept based on TL5 fluorescent lamps and digital electronic controls.



## Consumer Electronics

As a true top-three global player, Philips Consumer Electronics offers products designed to bring consumers the benefits of the latest digital technologies at any time and any place: at home, at work or on the move. The product range encompasses: widescreen and Flat TV; optical disc products including DVD recorders and Super Audio CD; digital television systems and Internet-connected devices including audio systems; other audio products such as portable audio products, mini and micro audio systems; PC peripherals such as PC monitors and DVD+RW data drives; and personal communication products including cellular phones and DECT phones. Philips Consumer Electronics has some 20,000 employees worldwide.

Digital Networks spearheads Philips' involvement in the emerging world of convergent digital content delivery, transforming the way we access television and the Internet at home or on the move. This business is creating the technologies to fulfill the promise of digital broadband via set-top boxes for consumers and end-to-end standards-based software solutions with which content providers and operators can create and deliver digital services.

*Building upon Philips' world-leading technology competences in display, storage and connectivity, Philips Consumer Electronics contributes to the Philips brand experience by enhancing consumers' everyday lives through innovative top-class products. Our aim is to be 'the brand people think of first' when it comes to digital entertainment, communication and information. Philips Consumer Electronics plans to achieve this ambition by focusing on the strength of the Philips brand, maintaining category leadership in display, storage and connectivity, managing costs and maximizing asset productivity.*

*In display, our leadership is based on creating the best picture quality and a natural viewing experience with flat, slim and wide displays. Storage means high-capacity, low-cost, robust storage solutions that allow consumers to easily store and access content, including high-quality video, audio, pictures and data. Connectivity enables the consumer to interact intuitively – anytime, anywhere – with wireless devices.*

*The pace at which the consumer electronics market is shifting from analog to digital is picking up fast. Digital products currently represent around 30% of the audio/video market and will increase to about 60% in 2005. Our strategy is to pro-actively manage the transition of our product portfolio from analog to digital and to shift even faster than the market. Examples include our outstanding LCD monitors and our range of DVD recorders, which we extended in 2002, bringing DVD recording within the reach of a broader, mass market audience.*



### Digital delights

Philips' new LX8000SA DVD/SACD Digital Home Entertainment System has an integrated DVD player and 6-channel digital sound receiver for movie playback with superb digital picture and sound quality. In addition, it also features playback of Super Audio CD discs – the latest evolution of the CD that takes a significant step forward in sound quality.

### Operational advances

In 2002 we further improved our operating performance. In our industry we are among the leaders in 'asset-light' performance. We are continuously minimizing the assets needed for our business through optimized supply chain management, an ODM business philosophy and outsourcing. In addition, we continue to optimize our manufacturing base, as evidenced by the divestment of our Contract Manufacturing Services group.

### US improvement program

A key area of attention is the performance of our US business, and an extensive turnaround program is being deployed. Enhancing our product offering and increasing our visibility in high-tier retail shops are key elements of this program. The new management team also decided to split the Philips brand from Magnavox, with Philips targeting the high-value consumer segments and Magnavox focusing on consumers looking for a value-for-money proposition. Significant steps have already been made in the Flat TV category, where surveys show spontaneous awareness of the Philips brand has gone up considerably. Also, our US field sales force has been expanded and upskilled. And in order to improve our





### **The world is yours**

With the introduction of new Internet-enabled products such as the MC-i200 Streamium micro hi-fi system, Philips is opening up an exciting new chapter in home entertainment, offering ultra-convenient access to online content.

supply chain management, we have outsourced our warehousing and all transportation to US retail customers from cross-border operations in Mexico.

### **The Consumer Experience**

Consumers are not interested in products as such, but rather in the experiences they deliver. Accordingly, we have adapted our business strategy to the concept of the 'Consumer Experience', comprising three domains – Home Entertainment, Personal Expression and Productivity. The first two are totally consumer-focused, while the third covers a broad range of professional, semi-professional, small-office and business-to-business applications.

### **Home Entertainment – customized solutions for the home**

The Home Entertainment experience targets consumers who desire customized and intuitive solutions for their homes, allowing them to enjoy watching and listening to their preferred choice of digital audio and video content. Our solutions offer these consumers the ideal combination of convenience, excitement and design.

### **Personal Expression – enjoying digital audio/video anywhere**

The Personal Expression experience is based on giving consumers – predominantly young people, who have a natural affinity with today's Internet-centric lifestyle – the freedom to enjoy the digital audio and video content of their choice, wherever they go.

### **Productivity – making professionals more efficient**

The Productivity experience focuses on delivering solutions that enable professionals – at home or at work – to do their jobs more effectively, more efficiently and more enjoyably. These include solutions for capturing information, storing and displaying it and making it easy to access, distribute and use, both for individual viewing and group presentations.

### **A whole new way to listen**

The design and performance innovations of Nike have been combined with the technology and research of Philips to create the first of a new generation of portable audio – FM, CD and MP3 players built specifically for runners and riders. Wearable, skip-free, sport ready.



# Domestic Appliances and Personal Care

Philips Domestic Appliances and Personal Care is engaged in developing, manufacturing and marketing innovative appliances in the fields of male shaving and grooming, oral healthcare, female beauty, food and beverage preparation, garment care and floorcare.

The division has just above 8,700 employees.

Sonicare toothbrush



## Innovative partnerships, delighted customers

Marketing is a top priority for DAP, and the division is continuing to strengthen this discipline, for instance through cooperation with major fast-moving consumer goods (FMCG) companies. We are creating unique, branded consumer value propositions by capability line-ups with best-of-breed FMCG companies. In 2002 we continued to build upon our successful co-branding/marketing initiatives, such as our Cool Skin shaver featuring Nivea additives and the Senseo coffee maker, the latter developed in partnership with Sara Lee|DE. Senseo represents a new and breakthrough consumable concept for the traditional coffee segment. The current success and potential of Senseo as a creator of value indicates yet again the importance of real innovations and effective marketing partnerships. Such partnerships enable us to capitalize on our differentiating capabilities (e.g. consumer insights, product design, branding, application know-how, global market presence). In addition, they provide access to new retail channels, industries and geographies. Consequently, we are aligning our business model with the dynamics and economics of FMCG manufacturers and the retail industry.

## Technology making the difference

At DAP we are constantly striving to improve our products through a combined effort in consumer

*Philips Domestic Appliances and Personal Care (DAP) holds market leadership positions through its portfolio of power brands in the personal care markets (Philishave worldwide, Norelco and Sonicare in the USA) and a strong Philips brand position in the domestic appliance markets, especially in Europe, Latin America and Asia Pacific.*

*In 2002 we not only outpaced market growth and posted improved results quarter by quarter, we also achieved an all-time high as a division in terms of sales, profitability and No. 1 and 2 market positions. We continued our efforts to drive down costs through cycle-time reduction, industrial relocation (to low-wage countries and/or to limit currency exposure) and asset/inventory management (diversity reduction). Further efficiencies were realized through headcount reduction (e.g. in our Latin America organization) and streamlining of the back offices in our Male Shaving & Grooming and Oral Healthcare sales organizations in the USA.*

intelligence and technology. New shaving technologies have led to substantial improvements to the core functionality of male shavers and female depilation products. And advanced surface treatments and coatings – for our shavers and irons, for instance – make for a much more pleasant and enjoyable user experience.

Through our acquisition of Optiva Corporation (Sonicare) in 2000, DAP has captured the industrial scale and differentiating sonic technology that will enable it to become an end-game player in the oral healthcare industry. Particularly encouraging results were posted in the USA and the UK in 2002.

## Sensotec

The new Philishave electric shaver with Personal Comfort Control for unsurpassed skin comfort and an extremely close shave was introduced in September 2002.



## Win-win

The year 2002 saw the next chapter in the success story that is the Senseo coffee maker; the breakthrough concept for the traditional coffee segment that we developed in partnership with Sara Lee|DE. Such co-branding/marketing initiatives enable the partners to capitalize on each other's distinctive capabilities and offer consumers an exciting new proposition.



# Components

Until year-end 2002 Philips Components was a major provider of integral digital electronic solutions in the areas of displays, optical storage and connectivity. With a global customer base covering the computing, consumer electronics, telecommunications and automotive industries, it produced: modules for optical storage in CD and DVD formats; mobile display systems for use in cellular phones and other handheld devices; wireless connectivity modules; speaker systems, tuners, remote control systems, multimedia projectors and digital display systems (LCD TV, etc.). In 2002 Philips Components employed some 13,000 persons.

## Components division dissolved

As part of our ongoing portfolio management program to strengthen our focus on digital technologies, downscale our involvement in more mature analog businesses and reduce complexity, we carried out a comprehensive review of our Components division in the course of 2002. This review resulted in measures to simplify the structure of our electronics activities and reduce costs, leading to the dissolution of the Components division and a restructuring program to bring Philips Optical Storage back to profitability.

## New configuration

The new configuration, which became effective on January 1, 2003, will streamline innovation and create more value through alignment of related businesses previously grouped in different divisions. Our telecom speaker activity has been combined with Mobile Display Systems and moved to Philips Semiconductors, offering customers a single source for complete and integrated solutions for the telecom and Personal Digital Assistant (PDA) markets. Similarly, certain digital display and audio/video wireless connectivity activities, including the Pronto remote controls group, have moved to Consumer Electronics. Again, this move is designed to reduce organizational complexity and duplication, and maximize synergies both for branded and OEM solutions. A stand-alone activity, New Displays Business Development, has been formed in order to strengthen our focus on new high-growth display opportunities, including the Liquid Crystal on Silicon (LCoS) and PolyLED technologies.

## Restructuring of Optical Storage

For Optical Storage, a comprehensive restructuring program is being carried out to bring the activity

back to profitability. The major part of the restructuring will see the PC-related (Data) business line concentrated in Taiwan. The R&D group in Eindhoven will be strengthened to concentrate on pre-development. The concentration of our data activities in Taiwan and our collaboration with BenQ will enhance Philips' focus on DVD+RW development. The turnaround in Data will be accelerated by focusing on the more profitable, high-growth segment of DVD+RW drives. By strengthening its position in DVD+RW applications and new or emerging standards, Philips will remain a leading player in the OEM and aftermarket optical storage industry with a solid basis for sustained profitability.

The consumer and automotive businesses of Philips Optical Storage are profitable and developing according to plan. The consumer line is a leader in the audio/video market and supplies drives for applications including DVD Recorders (based on the DVD+RW standard) and games consoles (Microsoft's Xbox). The Automotive line is a leader in its industry and growing significantly, mainly due to the switch from tapes to CDs and DVDs and the increasing application of navigation systems in cars.

## Wireless solutions merger

The wireless connectivity module activities of Components will be transferred to the new joint venture with Accton Technology Corporation of Taiwan, in which Philips will hold a 48% share. This joint venture was announced on January 8, 2003 and the deal is expected to be closed in the second quarter of 2003. The joint venture will provide innovative wireless connectivity (802.11) products for design-in (OEM) to, for example, the consumer electronics, enterprise, PC and mobile phone industries. The new company will address the increasing market requirements for advanced, easy-to-use and cost-effective wireless connectivity solutions based on state-of-the-art technology in Wi-Fi (802.11), Bluetooth™ and other industry standards.

As of 2003, the results of Optical Storage, the New Displays Business Development group and the businesses that are transferred to Philips Corporate Investments will be reported under Miscellaneous.

## Semiconductors

Philips Semiconductors is one of the world's top ten semiconductor manufacturers and a major supplier of innovative silicon solutions for consumer markets. These solutions are designed to grow and evolve as the applications develop. The division's multimarket approach maximizes the application scope for our leading-edge products. Philips Semiconductors has over 31,000 employees and operates in more than 50 countries.

*Philips Semiconductors envisions a world in which our lives are enhanced by technology that gives us anytime/anywhere access to information, entertainment and services. Philips Semiconductors' mission is to become the leading provider of semiconductor solutions for connected consumer applications. A cornerstone of the strategy for achieving this goal is to become the partner of choice for leading customers and content and service providers in these markets. 2002 was a very difficult year, with the deepest and longest recession that the semiconductor industry has seen in its fifty-year existence. Our 2002 revenues were down on 2001, but in line with the general market developments. In response to this situation we made significant cost savings during 2002, including announcing the closure of our plant in Albuquerque, New Mexico, USA. However, despite these adverse conditions we made progress on a number of fronts. Our focus on customer intimacy resulted in a series of important design wins, and many of the world's leading electronics brands are now using our Nexperia Multimedia Solutions platform. We continue to invest in innovation to drive growth and to move towards a more flexible cost structure in order to lower the structural break-even point.*

### Winning customers, Winning Philips

In 2002 the combination of our cutting-edge platform-based solutions and our focus on leading customers started to take effect, with significant design wins putting us in a good position to capitalize on the long-awaited upturn in the world's electronics market.

### Nexperia – living technology

Our Nexperia Multimedia Solutions provide customers with reconfigurable and re-usable solutions for full digital television. Indeed, three of the world's top five TV makers apply our Nexperia solutions in their digital TV products. Over 70% of the world's DVD+RW recorders made in 2002 contained a Philips Nexperia solution. Philips expects that over the next five to seven years a significant proportion of the installed TV base in Europe and the US will be replaced by new integrated digital TVs, and Philips Semiconductors is uniquely positioned to take advantage of this new market. Over 60% of all TVs sold in 2002 contained a Philips Semiconductors product.

In 2002 we strengthened our position in the mobile phone market. By the end of 2003 we expect that one in every ten mobile phones made in the world will have a Philips Nexperia system solution inside. This system solution enables mobile phone makers to bring new mobile phone designs to market quickly. Our system solutions are ready for all the new mobile phone technologies that will come onto the market in 2003 and 2004 (GPRS, G2.5, G3, etc.).





### Getting closer

Our customer intimacy program has reinforced our relationship with key players in the computing market. We are a leading provider of semiconductors to the major producer of LCD monitors and have won important customer-specific designs for a key printer manufacturer. Our customer-specific products are also used in many PDAs, and Intel has chosen our power management system for their latest motherboard designs.

During 2002, one of the world's leading clothing chains selected our identification chip for incorporation in their garments. At first they will use the chip for tracking throughout their manufacturing and logistics chain, and then as a security device in shops. In the longer term it can also be used as part of their customer relationship management.

### Technology breakthroughs

Philips continues to develop leading solutions for the wireless and wired connectivity markets. Our acquisition of Systemonic will increase our ability to hold leading positions in the 802.11 standard for wireless connectivity, and we will be the first company to release silicon for the new ZigBee standard. Philips maintained its leadership in Bluetooth™ by delivering over 10 million units of low-power, low-cost system solutions targeting voice and data applications.

During 2002 we jointly announced with Sony a new standard for secure Near-Field Communication (NFC). Near-Field Communication allows the transfer of any kind of data between NFC-enabled devices such as mobile phones, digital cameras, PDAs and PCs over a distance of up to twenty centimeters. NFC will deliver speeds fast enough to transfer high-quality

images in a secure and seamless way. This will enable the development of several new markets, including electronic toys, and easy uploading of music and software from main players to portable machines.

Philips is in the forefront of new technologies for semiconductors. With our partners Motorola and STMicroelectronics, our wafer fab in Crolles, France, will start producing leading-edge 120 nm wafers for a number of new products in 2003. The 90 nm development is proceeding very well, and we expect to commence pilot production by the end of 2003. In January 2003 we demonstrated a world first – functional memory cells in 65 nm technology. These new technologies will lead to lower-power, higher-speed and smaller-area semiconductors, which are needed for the next generation of mobile phones, PDAs and other portable devices.

### Framework in place

Philips Semiconductors has winning technologies, in winning products, with winning customers throughout the world. Building upon our advanced silicon processes, design gains and customer intimacy, we are determined to deliver operating profitability by gaining sales and market share and by lowering costs.



## Medical Systems

With approximately 31,000 employees and a presence in more than 100 countries worldwide, Philips Medical Systems holds global No. 1 or 2 positions in most of the markets it serves. The product range includes best-in-class technologies in X-ray, ultrasound, magnetic resonance, computed tomography, nuclear medicine, positron emission tomography, patient monitoring, clinical information management and resuscitation products, as well as a comprehensive range of customer support services.

*Advancing its mission to become the industry leader in meeting the changing needs of healthcare providers worldwide, Philips Medical Systems took significant steps in 2002 to strengthen its position in its key markets. This included an accelerated program of product innovations that have reinforced our technology leadership in imaging, patient monitoring and IT. Major steps were also taken to execute the program integrating the division's recently acquired market- and technology-leading companies to form a strong, harmonized market presence and an effective, competitive organization. The result is a significant increase in the reach of the Philips brand to important target audiences, for example with a 50% installed base in US hospitals in the critical care area.*



### **Holding the heart in your hands**

The SONOS 7500 Live 3D Echo ultrasound system provides real-time images of the heart and the complex interactions between its valves, chambers and vessels with such clarity and detail that it has been described as similar to "holding the heart in your hands".

### **Continuing series of innovations**

The pursuit of clinical excellence is the driver behind a continuing series of innovations in imaging technology and clinical information system applications. These enhance both diagnostic capabilities and clinical efficiency. For example, the Intellivue Patient Monitoring System gives physicians instant access to all relevant patient information and diagnostic images at the patient's bedside. Intellivue can help speed up treatment decisions and enhance the quality of care by using web-based technology that provides vital information to clinicians at the moment they need it most.

In the area of cardiac imaging, Philips' latest technology innovation, Live 3D Echo, is revolutionizing echocardiography. Never before have clinicians been able to view three-dimensional ultrasound images of the beating heart in real time. Offering amazing clarity and detail, this powerful new tool enables clinicians to observe complex interactions between valves, chambers and vessels in 3D, as they happen. Live 3D will transform echocardiography by providing more complete information to enhance and speed clinical decision-making.

And in the field of computed tomography, Philips was the first manufacturer to obtain clearance from the US Food & Drug Administration (FDA) for sale of its latest 16-slice CT scanner, the Mx8000 IDT. With its thinner image 'slices', this new scanner allows physicians to see details that have never before been visible, such as narrow arteries or tiny lesions. This capability brings the promise of earlier and more precise diagnosis of a wide range of conditions, including cardiac disease, cancer, stroke and trauma.



### Technology for lower costs and greater effectiveness

The commitment to clinical excellence also manifests itself in the drive to enable healthcare providers to reduce their operating costs, while at the same time improving patient treatment and outcomes. This includes applying technology to allow earlier diagnosis, reducing the need for more costly treatment at a later stage, as well as developing ways to make treatment more effective, e.g. through virtual real-time monitoring of the efficacy of medication.

Key to the efficient and effective use of technology is the management of clinical information. In 2002, Philips Medical Systems introduced Vequion, Philips' family of clinical IT products, systems, solutions and services. Among its customer benefits is the provision of a single user interface with the system regardless of location – from the imaging modality exam room to the physician's office or the nurse's station and across all of Philips' imaging modalities. Vequion supports 'smart' applications that can be tailored to individual users or departments, and uses IT standards that connect seamlessly to legacy systems. This translates into less training time, less installation time, faster diagnoses and faster treatment solutions.

### Partnerships driving products and services forward

Partnerships are a key factor in driving product development and enhanced clinical services. In 2002, Philips and Rabobank Group subsidiary De Lage Landen International set up a joint venture to provide financing in the United States for the full range of diagnostic imaging equipment produced by Philips Medical Systems. The new venture, a fully consolidated subsidiary of De Lage Landen (which owns 60%), is called Philips Medical Capital. The joint venture will



increase Philips' ability to provide financial services, including asset management, to its customers, further strengthening its overall position in the market.

Philips Medical Systems is also working in partnership with key academic institutions to accelerate the transformation of new scientific discoveries into cutting-edge clinical imaging systems. With Washington University in St. Louis, Missouri, Philips is using so-called 'targeted nanoparticles' that attach to specific parts of the body to detect the very early stage of a disease. For example, using MR, ultrasound or nuclear imaging techniques, the aim is to visualize inflamed arteries that are the cause of a heart attack or stroke. Or to detect cancer at an early stage, when it can be treated using the same nanoparticles that can carry therapeutic drugs or genes directly to the right part of the body.

### Dedicated customer focus

At the core of all the division's technological and market developments is the passion and dedication of our employees and their visible commitment to build a single, strong, multidisciplinary Philips Medical Systems team with an overriding focus on serving customers' needs – and ultimately making a difference to people's lives. Illustrating the success of this approach, MD Buyline – an independent US research company that advises healthcare providers on buying and implementation decisions for medical technology – ranked Philips number one in 15 out of 26 product categories.

## Technology & Design

Founded in 1914, Philips Research is one of the world's major private research organizations, with main laboratories in the Netherlands, the United Kingdom, Germany, the United States and China, together employing some 2,500 people.



### Painting a display

In the May 2002 issue of *Nature*, scientists from Philips Research described the fabrication of liquid-crystal displays (LCDs) by simple coating techniques, comparable to painting. This makes displays cheaper and thinner and provides considerable design freedom. The displays can be made on a wide variety of substrates, including plastic, enabling for example large, paintable displays on walls or flexible displays integrated in clothing.

### Tiny giant

Having invented the Compact Disc, Philips continues to spearhead the efforts to take optical recording forward to increased storage densities, higher recording speeds and new applications. In 2002, Philips demonstrated a prototype of its Small Form Factor Optical (SFFO) Storage solution, which is suitable for portable applications such as notebooks, PDAs, mobile phones and digital cameras. SFFO technology will meet the extra storage demands placed on such devices by audio, video, gaming, imaging and data content. Using blue-laser technology, up to 1 gigabyte of data can be stored on a 3 cm optical disc, more than 1.4 times the storage capacity of a CD-ROM.

*Philips plays a leading role in shaping the world of digital electronics by bringing meaningful technological innovations to people. Many of these innovations have their roots in the laboratories of Philips Research. Creating value and growth by generating new technologies for the various Philips businesses is the main focus of Philips Research. Drawing upon our deep and broad technology foundation, scientists at Philips Research are constantly striving to break down the barriers between technology and application domains in order to achieve the synergies that will lead to new product concepts and new business.*

*At Philips Research, scientists from a wide range of disciplines and backgrounds work together, influencing and broadening each other's views, thus enabling the Philips businesses to reap the benefits of diversity, cross-fertilization of ideas and synergy. To give just one example of the diversity of our organizational fabric, more than 50% of all new employees at Philips Research in the Netherlands are recruited from abroad.*

### Fruitful cooperation

Almost immediately after the discovery of light-emitting polymers in 1990, Philips Research began investigating the possibility of using these materials in display devices. Encouraging results led to the opening of a pilot factory for polymer organic light-emitting displays (PolyLEDs) by Philips Components in 1998. Since then, Research and the businesses have cooperated closely on the optimization of materials, manufacturing and assembly and on the design of modules and driver ICs. In 2002, Philips became the first supplier to start shipping volume quantities of PolyLED modules. Meanwhile, Research is focusing on technologies for next-generation PolyLED devices, including full-color displays made by inkjet printing.



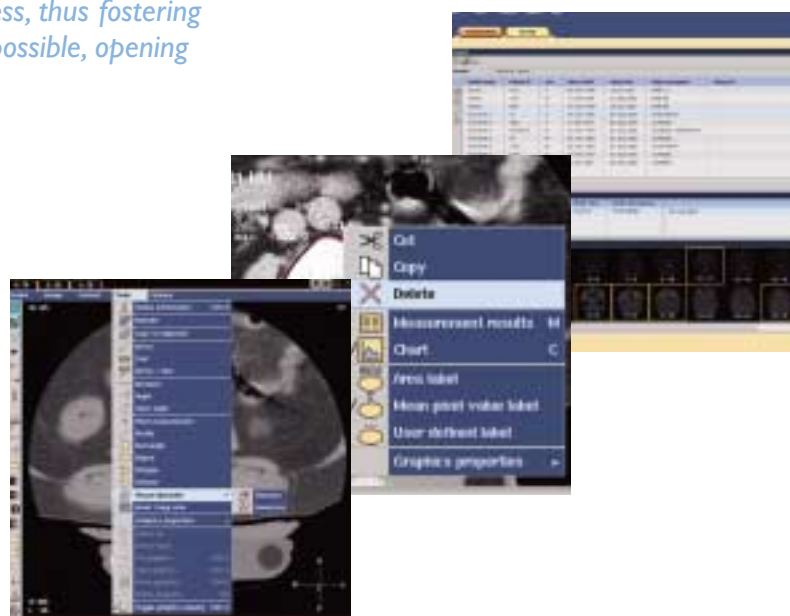


Philips Design is dedicated to creating value by delivering innovative and meaningful solutions that humanize technology. With 450 employees active in 12 locations around the world, Philips Design serves all Philips' businesses and a select portfolio of external customers.

Philips Design's key objectives are to provide best-in-class, sustainable design leadership, to offer competitive services to the Philips businesses, and to be the custodian of Philips' brand identity design. Its proprietary High Design process has made it an industry leader. This human-focused approach is based upon in-depth research into people – their behavior, their relationship with technology, socio-cultural dynamics, evolving lifestyles worldwide – and upon applying the results of that research to the innovation process, thus fostering cross-business and cross-company synergies and, wherever possible, opening up new business opportunities for Philips.

### Consistently user-friendly

As Philips Medical Systems' product portfolio expanded, so did the number of different user interfaces. Philips Design helped the division to develop a generic interface that enhances ease of use, communicates a consistent 'look and feel' across product lines and facilitates efficient re-use.



Intellectual Property & Standards (IP&S), formed on January 1, 2002 through the merger of Corporate Intellectual Property and System Standards & Licensing, is the organization responsible for managing Philips' intellectual property. The activities of IP&S include the creation of all intellectual property rights, including patents, trademarks, designs, domain names and copyrights, as well as the commercialization of these rights. In addition, IP&S plays a leading role in establishing standards in specific technical fields, such as optical storage, in cooperation with Philips Research and third parties. IP&S also exploits Philips' technologies through the transfer of know-how and licensing of the associated intellectual property rights to third parties.

In 2002 the number of patent filings was about 3,000, the same high level as in the record year 2001. As a result of the increased filings over the last two years, the total worldwide patent

portfolio grew by more than 10% in 2002 and now comprises some 85,000 patent rights. The aim is to extract maximum value from this portfolio through a structured process of identification and verification of valuable patents.

Philips' Centre for Industrial Technology (CFT) is a renowned center of competence supporting the product divisions and a number of external high-tech companies in all aspects of technology and production, particularly in the fields of mechatronics, electronics, process technology, assembly and industrial support.

In 2002 CFT made a number of key contributions to the manufacture of innovative new products. For example, it greatly simplified the production process for PolyLED displays, as used in Philips' new Sensotec shaver, eliminating the problem of water vapor ingress, which caused rapid degeneration of the PolyLED material.



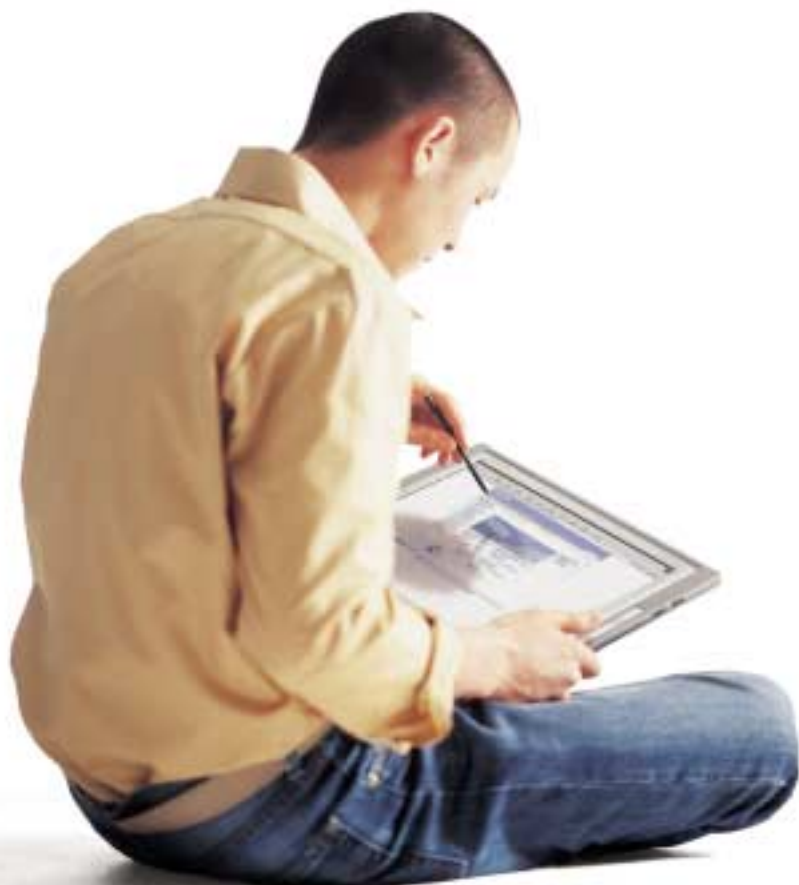
## Report on the performance of the Philips Group

The following discussion is based on the consolidated financial statements and should be read in conjunction with the other financial information.

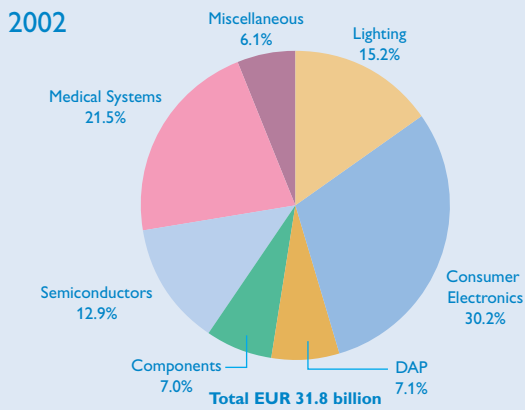
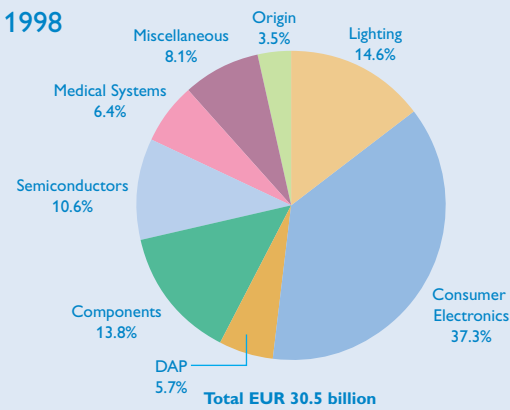
Starting January 1, 2002 the consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP). All previous periods have been restated according to US GAAP.

This section of the Annual Report represents a summary of the Operating and Financial Review and Prospects as included in the separate booklet entitled 'Financial Statements and Analysis'.

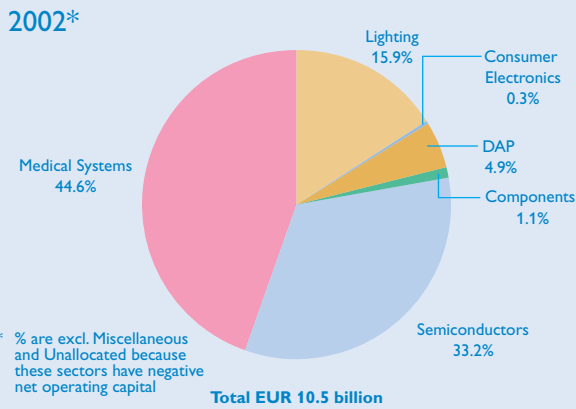
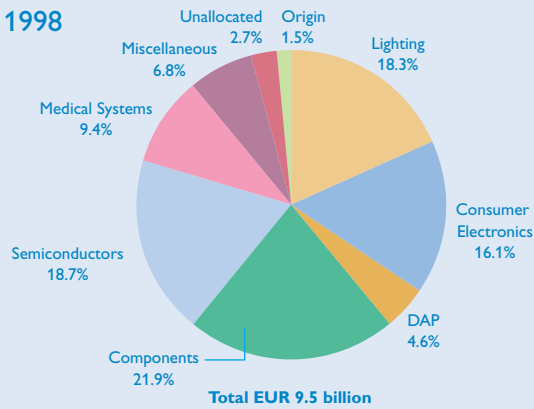
In order to facilitate a better understanding of the underlying business performance of our segments, we have analyzed the results of operations with a discussion of special items. Special items, as presented in the Report on the performance of the Philips Group, relate to income and expenses resulting from business operations, which, because of their nature, are disclosed separately to give a better understanding of the underlying result for the period. These include items such as restructuring and impairment charges, acquisition-related charges and gains and/or losses on the disposal of businesses or participations and real estate. This is consistent with how business performance is evaluated by management. However, the reader should note that net income excluding special items is not a measure of financial performance as defined by US GAAP or Dutch GAAP. The reader is encouraged to give equal attention to the reported GAAP measures and the analysis excluding special items.



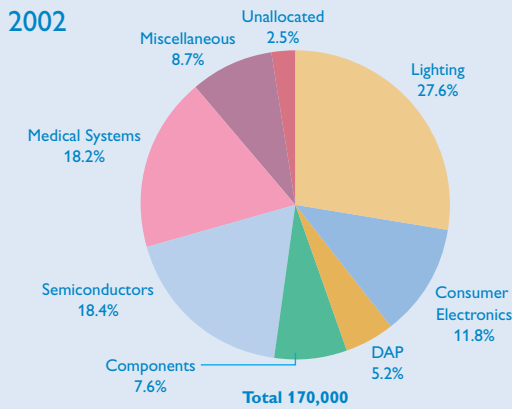
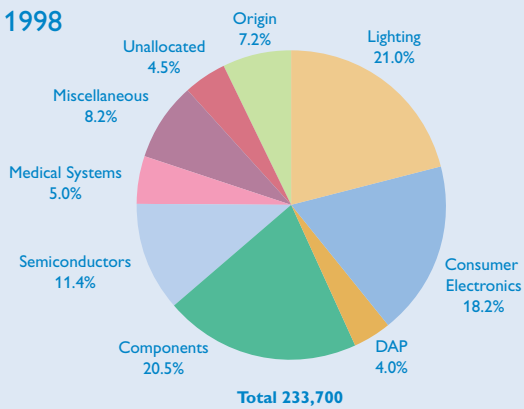
Sales per sector (as a % of total)



Net operating capital per sector (as a % of total)



Headcount per sector (as a % of total)



### Tightened focus

Over the last five years, Philips has become a more focused, leaner and more agile organization, better able to react to the continual changes we are confronted with in today's business environment.

In particular, we have:

- invested in businesses that are established or potential world leaders;
- reduced our exposure to more volatile and unprofitable businesses and industries;
- limited our exposure to market fluctuations by outsourcing production, reducing overcapacity and expanding partnering;
- reduced our cost structure;
- rationalized our portfolio by divesting businesses that were unprofitable or did not fit with our long-term strategy;
- further enhanced our strong position in two cash-generating businesses, Lighting and DAP.

As a result of both significant acquisitions and organic growth, Medical Systems now represents 22% of our total sales, compared with 6% only five years ago. It accounts for 45% of our net operating capital (NOC), compared with 9% in 1998. With our integration program on track, Medical Systems is expected to deliver strong results going forward.

Semiconductors has closed old manufacturing facilities and built capacity through expanded partnering (e.g. STM, Motorola, TSMC), while positioning itself to participate in the future economic recovery by increasing R&D on improved platform designs.

Increased outsourcing and more effective asset management have enabled Consumer Electronics to reduce its net operating capital from EUR 1.5 billion in 1998 to virtually nil today.

Our exposure to volatile and often unprofitable industries has been reduced by increasing partnering (e.g. in display, semiconductors), closing unprofitable businesses and changing business models (e.g. for set-top boxes, mobile phones, optical data storage).

Over the last 5 years productivity per employee has improved through headcount reductions and divestments, sales per employee increasing by 44%.

During the boom in the stock markets in the late 1990s we benefited by selling parts of our non-strategic public holdings such as PolyGram, ASML, JDS Uniphase and Origin, realizing book gains totaling almost EUR 11 billion, of which about EUR 9 billion was received in cash. When the stock markets subsequently came down, we had to take non-cash impairment charges of about EUR 3.5 billion on our remaining shareholdings.

### The year 2002

- **Income from operations of EUR 420 million**
- **Net income: a loss of EUR 3,206 million; excluding special items a profit of EUR 208 million**
- **Further rationalization of manufacturing and cost base and progress in overall cost-reduction programs**
- **Components division dissolved January 1, 2003; a number of non-strategic businesses sold**
- **Positive cash flow from operating activities amounting to EUR 2,228 million, driven by tight working capital management**
- **Net debt to group equity ratio 27:73**

### Impairments/value adjustments of shareholdings and securities

in millions of euros	2000	2001	2002
Vivendi/Seagram	1,115	(440)	<b>(1,855)</b>
JDS Uniphase	1,207	-	<b>(73)</b>
Great Nordic	-	(86)	<b>(27)</b>
	2,322	(526)	<b>(1,955)</b>
LG.Philips Displays	-	-	<b>(275)</b>
Atos Origin	1,072	-	<b>(921)</b>
Various unconsolidated companies	-	(119)	<b>(109)</b>
	1,072	(119)	<b>(1,305)</b>
Total	3,394	(645)	<b>(3,260)</b>

### Net income excluding special items

in millions of euros	2000	2001	2002
As published	9,662	(2,475)	<b>(3,206)</b>
Special items:			
affecting income from operations	1,070	(1,235)	<b>(40)</b>
affecting financial income and expenses	2,322	(526)	<b>(1,888)</b>
affecting results relating to			
unconsolidated companies	3,397	(248)	<b>(1,613)</b>
income taxes related to special items	(18)	313	<b>127</b>
Excluding special items	2,891	(779)	<b>208</b>

### Summary

Markets in 2002 were a repeat of the markets in 2001. The telecommunications and PC-related markets and business investments in IT products and services in general continued to suffer during 2002. These markets seemed to be starting to recover in the first quarter, but the improvements did not follow through during the rest of the year. Philips' management focused its attention on managing those activities it *can* control: costs, cash flow, tight asset control, strengthening its innovation and other operational processes, and reducing debt. As a result, margins in all our divisions improved compared with 2001. Furthermore, 2002 net income was positively impacted by savings resulting from our overhead cost reduction program (EUR 257 million) and lower goodwill amortization (EUR 413 million), and was adversely affected by a significant increase in pension costs (EUR 541 million). Philips was able to generate a EUR 2,228 million positive cash flow from operating activities. Gross capital expenditures were scaled back compared with 2001, to EUR 1,161 million.

### Special items

Main financial markets around the world closed with negative results for the third year in a row, impacting the valuation of the Company's financial assets.

During 2002 the Company took charges of EUR 1,955 million for writing down the valuation of its securities (mainly Vivendi Universal). Also, the Company took impairment charges totaling EUR 1,305 million for its shareholdings in unconsolidated companies (mainly Atos Origin and LG.Philips Displays). Other special items that impacted the Company's income from operations were:

- restructuring expenses and asset impairments of EUR 513 million in our divisions and EUR 301 million with respect to our unconsolidated companies;
  - acquisition-related charges of EUR 96 million, mainly at Philips Medical Systems; and
  - gains from the sale of businesses or assets, which made a positive contribution of EUR 569 million, reflecting the successful continuation of the low-growth low-return divestment program.
- Excluding all special items, net income would have been EUR 208 million.

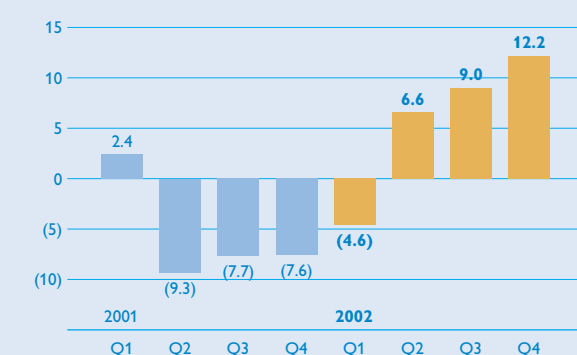
## Continued weak markets in 2002

		2000	2001	2002*
PCs	millions of units	136	130	132
	% growth	16	(4)	1
Cellular phones	millions of units	416	400	410
	% growth	49	(4)	2
Cons. electronics	value in billions of euros	96	91	87
	% growth	20	(5)	(4)
Semiconductors	value in billions of euros	222	156	149
	% growth	58	(30)	(5)

\* provisional data

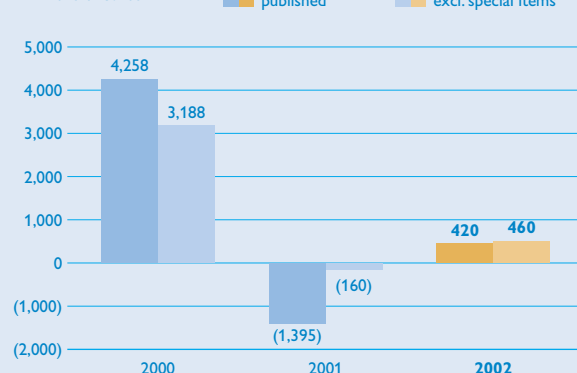
## Quarterly sales volume growth 2001-2002

in % year-on-year



## Income (loss) from operations

in millions of euros



## Group sales and income from operations

### Sales

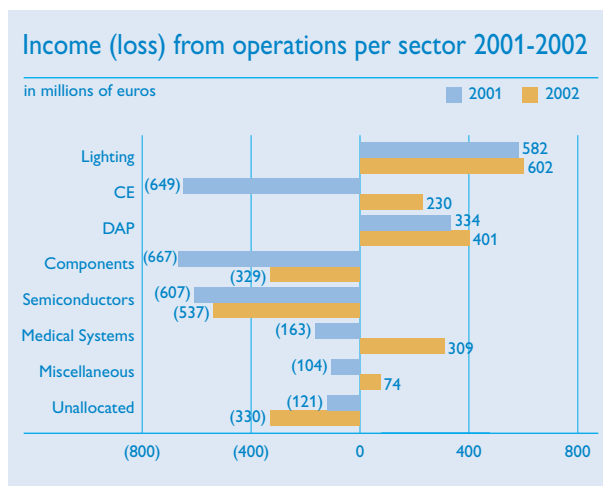
Sales in 2002 totaled EUR 31,820 million, 2% lower than in 2001. Changes in consolidation had a net positive effect of 3%, while the weakening of the dollar and related currencies had a 4% negative effect, particularly in the second half of the year. Sales volume grew by 6%, in contrast to a 6% decline in 2001. The year-over-year growth trend improved every quarter in 2002. Price erosion eased somewhat in 2002: 7% compared with 8% in 2001.

Growth was achieved in the sectors DAP, Components (predominantly in Mobile Display Systems) and Medical Systems (42% growth, of which 5% was organic growth). Sales were somewhat lower at Lighting and Semiconductors. The lower sales in the Consumer Electronics sector were caused by lower volumes for mobile phones and set-top box products (as a consequence of the changed business models in 2001), which were not offset by solid growth in TV and DVD products in particular.

### Income from operations

Income from operations improved by EUR 1,815 million to a profit of EUR 420 million; excluding special items and goodwill amortization (the latter totaling EUR 180 million in 2001), income improved by EUR 440 million to EUR 460 million notwithstanding an increase of pension costs of EUR 541 million. The strong improvement of margins in all sectors can be attributed to the close attention the Company gave to margin and cost management during 2002. We announced cost-saving programs intended to deliver a EUR 1 billion run-rate saving by the end of 2003. With regard to the EUR 300 million overhead cost reduction program, we realized savings of EUR 257 million in 2002 and achieved a run-rate saving of EUR 324 million in the last quarter of 2002. Medical Systems already realized savings of EUR 173 million in 2002. Detailed programs are in place to realize the remainder of the EUR 350 million savings in 2003.

Income increased by more than EUR 425 million due to the effects of the 2001 restructuring program.



Net gains resulting from the sale of businesses and real estate amounted to EUR 569 million. The ongoing divestment program led to special gains of EUR 311 million, of which the gains from the sale of Analytical (EUR 85 million), Philips Broadband Networks (EUR 49 million) and PCMS (EUR 83 million) were the most significant. Other special gains related to the sale of real estate (EUR 65 million), an earn-out of JDS Uniphase shares (EUR 113 million), the sale of Components' glass activities (EUR 40 million) and a currency translation gain from the liquidation of certain Components activities in Japan (EUR 40 million).

Restructuring and impairment charges, net of releases, in 2002 totaled EUR 513 million; this included restructuring charges of EUR 96 million for the PCMS factories. Prior to the sale of Health Care Products (HCP), an impairment charge of EUR 47 million was taken in order to bring the value of the assets in line with the sale price.

The major restructuring projects were at Components (dissolving the division and reorganizing the optical storage activities) and Semiconductors (closure of the Albuquerque plant). The future annual savings generated by the restructuring projects, once fully implemented, are estimated at approximately EUR 325 million.

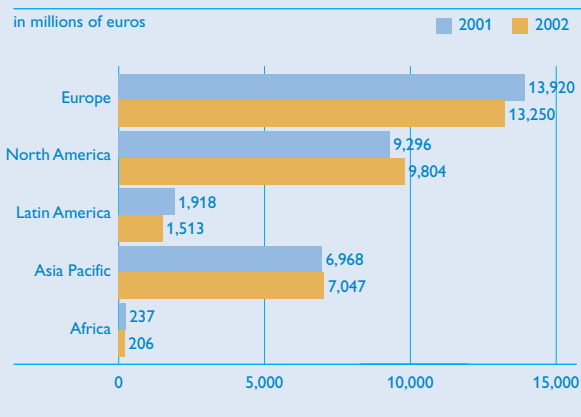
The Marconi and Agilent acquisitions and the integration of those businesses into our Medical Systems division led to special charges of EUR 84 million, far below the integration savings already realized in 2002.

Income (loss) from operations		
in millions of euros		
	2001	2002
Income from operations		
excluding special items		
and amortization of goodwill	20	460
Special items	(1,235)	(40)
Amortization of goodwill	(180)	-
Income (loss) from operations	(1,395)	420

Special items affecting income (loss) from operations		
in millions of euros		
	2001	2002
Sale of businesses and real estate	295	569
Restructuring and impairment charges	(1,093)	(513)
Acquisition-related charges	(331)	(84)
Write-off of acquired in-process R&D	(106)	(12)
Total	(1,235)	(40)



## Sales per geographic area 2001-2002



## Sales and income from operations by geographic area

### Sales

Sales in Europe declined by 5%, partly due to the unfavorable effect of consolidation changes. Additionally, the weak economy in Germany had a downward effect on sales. Sales in North America increased by 5%, lifted by the new consolidations at Medical Systems, partly offset by a weaker us dollar and weak semiconductor demand. Sales in Latin America were 21% lower, due, in particular, to the economic downturn in Argentina and Venezuela. Sales growth in Asia Pacific, at 1%, was hampered by the negative effect of deconsolidations and weaker currencies. On a comparable basis, sales expanded by 8%. Strong growth was posted in China (26%) and South Korea (22%), while sales declined in Japan.

## Income (loss) from operations per geographic area

in millions of euros	2000	2001	2002
Europe	3,246	(487)	881
North America	186	(851)	(521)
Latin America	59	(13)	23
Asia Pacific	764	(34)	30
Africa	3	(10)	7
Total	4,258	(1,395)	420

### Income from operations

The improvement in income from operations on a global level was also visible in the performance of the various regions. All regions improved their profitability, especially Europe and North America. However, despite the considerable improvement in North America, this region was still loss-making, mainly due to Semiconductors, Components, Consumer Electronics and acquisition-related charges at Medical Systems.

## Results relating to unconsolidated companies

in millions of euros	2000	2001	2002
Income (loss) excluding special items and amortization of goodwill	683	(103)	291
Special items:			
impairment charges	-	(119)	(1,305)
other	3,397	(129)	(308)
Amortization of goodwill	(124)	(257)	(24)
Total	3,956	(608)	(1,346)

### Results relating to unconsolidated companies

In general, the operating results excluding amortization of goodwill improved compared to 2001. The operational performance of LG.Philips LCD improved due to a strong overall LCD market with increased price levels, particularly in the first half of 2002, and much higher volumes.

Taiwan Semiconductor Manufacturing Company (TSMC) maintained profitability but suffered from declining markets in the second half of 2002. Its utilization rate slipped to 61% in the last quarter. TSMC still outperforms the semiconductor industry as a whole, because of the increased outsourcing by electronics companies.

LG.Philips Displays' operational performance improved compared to 2001. Restructurings were carried out to relocate to lower cost regions and to dispose of or shut down manufacturing sites, and lower operating costs were realized. The restructuring

### Results relating to unconsolidated companies (excluding special items and amortization of goodwill)

in millions of euros	2000	2001	2002
SSMC	(31)	(84)	(54)
LG.Philips LCD	207	(125)	169
LG.Philips Displays	-	(86)	18
Others	507	192	158
Total	683	(103)	291

and asset impairment charges negatively impacted net income by EUR 301 million.

Additionally, impairment charges of EUR 275 million were recognized in connection with our investment in LG.Philips Displays; a EUR 921 million write-down of our investment in Atos Origin to its lower market value was also recognized.

### Restructuring and asset impairment

In 2002 we made further progress in aligning our portfolio, and we took measures to develop a more flexible cost base and to further improve efficiency. This led to restructuring and impairment charges of EUR 513 million for various projects, net of releases of EUR 78 million. The most significant restructuring and impairment charges in 2002 related to:

- the dissolution of Components (EUR 78 million);
- rationalization of the product portfolio of Optical Storage (EUR 104 million);
- reduction of excess capacity at Semiconductors (EUR 180 million);
- reduction of PCMS manufacturing capacity at Louviers, Juarez and Hasselt (EUR 96 million);
- several programs at Lighting in the Netherlands (EUR 20 million);
- closure of Monitors' production facilities in Mexico (EUR 11 million);
- reduction of Research activities (EUR 12 million);
- HCP asset and goodwill impairment (EUR 47 million).

### Estimated annualized future savings

in millions of euros	2001		2002	
	Restructuring	Savings	Restructuring	Savings
Lighting	18	13	13	10
Cons. Electronics	503	127	100	58
DAP	4	-	9	6
Components	156	93	165	127
Semiconductors	204	101	169	87
Medical Systems	75	22	43	-
Miscellaneous	96	75	14	33
Unallocated	37	6	-	-
Philips Group	1,093	437	513	321

The future annual savings from the above restructurings are estimated at around EUR 325 million.

### Financial income and expenses

in millions of euros	2000	2001	2002
Interest expenses (net)	(167)	(391)	(384)
Impairment of securities	-	(526)	(1,955)
Sale of securities	2,173	-	67
Other	(13)	2	45
Total	1,993	(915)	(2,227)

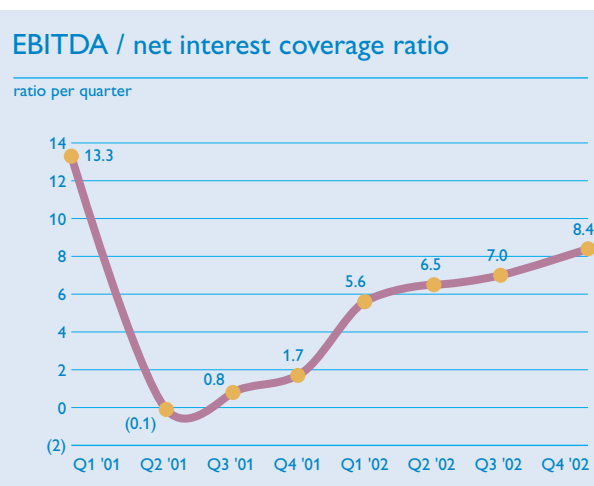
### Financial income and expenses

Net interest expenses were slightly lower in 2002 than in the previous year due to lower interest rates.

Due to the lower share prices of some security investments, a value adjustment of EUR 1,955 million was recognized, mainly in respect of Vivendi Universal. The partial sale of our stake in ASML resulted in a gain of EUR 67 million.

### Income taxes

Income taxes represented a charge of EUR 27 million in 2002, compared to a benefit of EUR 428 million in



2001. For the coming year, the Company expects an effective tax rate of approximately 25%.

### Minority interests

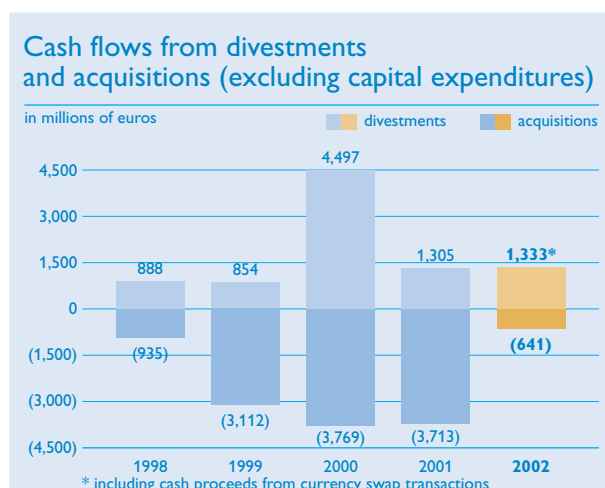
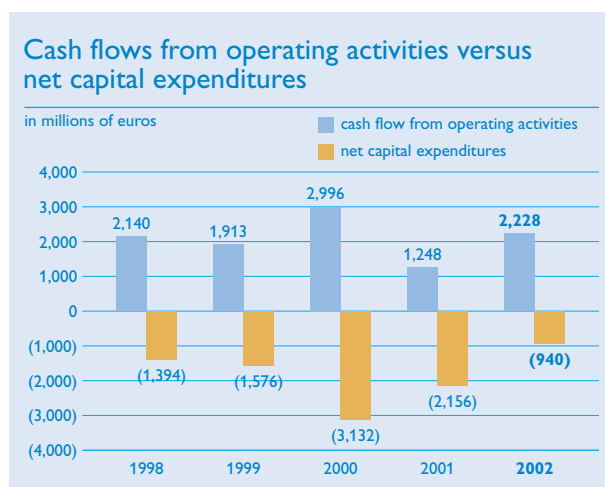
In 2002 the share of third-party minority interests in the income of group companies amounted to EUR 26 million, compared with a share in the loss of EUR 15 million in 2001. The change is mainly attributable to excess dividends received in 2001, relating to minority shareholdings, which did not occur in 2002.

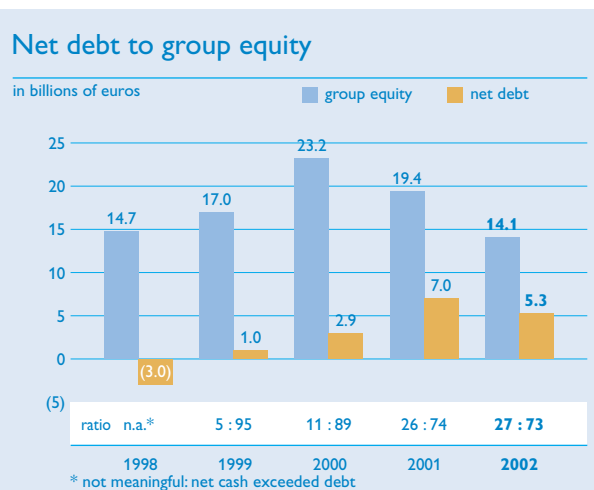
### Cash flows

Philips was able to generate an improved operating cash flow of EUR 2,228 million in 2002, compared to EUR 1,248 million in 2001. Our cash conversion cycle improvement program continued to bear fruit and led (excluding currency and consolidation effects) to lower inventories, higher payables and lower receivables. Inventories at the end of 2002 reached an all-time low of 11.1% of sales, compared to 13.3% a year earlier. Consumer Electronics in particular drastically reduced its cash conversion cycle to a level close to nil.

Cash used for investing activities in 2002 mainly comprised:

- net capital expenditures of EUR 940 million, which were scaled back by approximately half compared to 2001 as we aligned our Components and Semiconductors manufacturing facilities to the lower level of market demand;
- EUR 641 million that was used for acquisitions, of which the most important were the settlement and capital injection in the joint venture LG.Philips Displays of EUR 250 million, a final payment to Agilent of EUR 90 million and a capital injection of EUR 69 million to SSMC;
- EUR 1,333 million cash proceeds. The sale of businesses, of which Philips Contract Manufacturing Services (PCMS), Analytical and Communication, Security and Imaging (CSI) were the most important, generated EUR 813 million. In addition, EUR 422 million was received from the resetting of currency swap transactions, while proceeds from the sale of shares amounted to EUR 98 million (of which ASML shares of EUR 72 million).



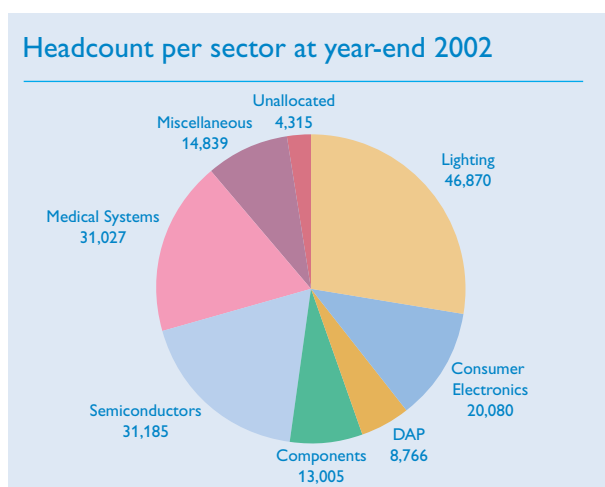


In 2002, net cash used for financing activities amounted to EUR 897 million. Repayment of short-term debt was offset by EUR 300 million of newly issued long-term debt. In 2002 a distribution in cash of EUR 459 million was made to Philips shareholders (2001: EUR 458 million).

### Financing

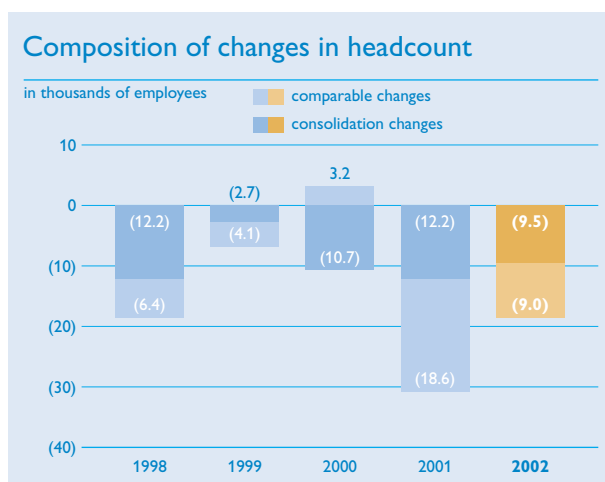
At the end of 2002, Philips had a net debt position of EUR 5,251 million, which was EUR 1,725 million down from 2001. The net debt to group equity ratio was 27:73, compared to 26:74 in 2001.

Stockholders' equity decreased by EUR 5,241 million to EUR 13,919 million at year-end 2002. This decrease was mainly due to the net loss of EUR 3,206 million in 2002, negative currency translation effects, unrealized losses related to available-for-sale securities and adjustments for pension liabilities charged against equity. Furthermore, EUR 459 million was paid to shareholders from retained earnings.



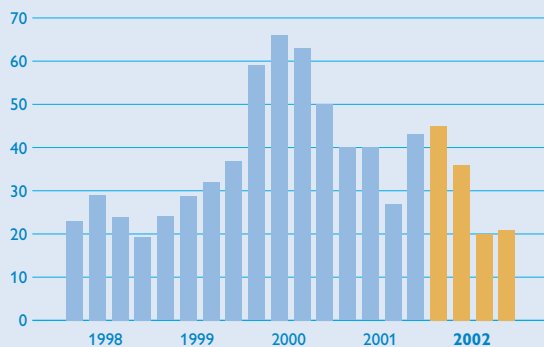
### Employment

The number of employees at the end of December 2002 totaled 170,087, a decline of 18,556 from December 31, 2001. Part of the reduction (9,514) was caused by consolidation changes. Excluding these changes, the headcount reduction came to 9,042, mainly centered on Consumer Electronics, Semiconductors and Corporate Investments. The headcount at Medical Systems increased by 846 employees as a result of expansion of the business. In geographical terms, Europe and Asia Pacific accounted for most of the decrease. The headcount reduction was most significant in the production and general administrative areas, while the R&D area was less affected.



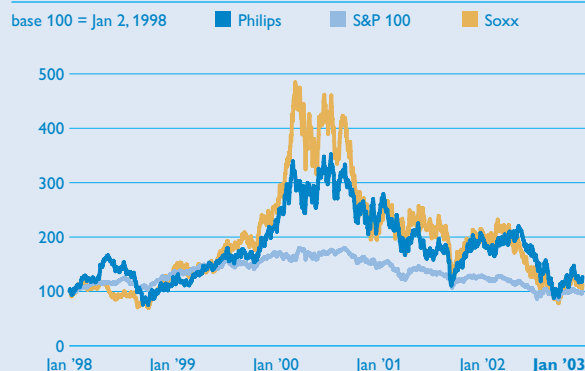
## Market capitalization

in billions of euros



## 5-year relative performance: Philips, S&P 100, Soxx

base 100 = Jan 2, 1998



## Dutch GAAP

The Group financial statements have been prepared in accordance with US GAAP (Generally Accepted Accounting Principles in the United States), which differ in certain respects from Dutch GAAP. As of January 1, 2002 the most important difference relates to goodwill, which under Dutch GAAP is amortized, whereas under US GAAP it is tested for impairment. Net income determined in accordance with Dutch GAAP came to a loss of EUR 3,602 million in 2002, compared with a loss of EUR 2,608 million in 2001. These aggregate amounts result in basic earnings per common share of a loss of EUR 2.83 in 2002 and a loss of EUR 2.04 in 2001. For both years no dilution effects are taken into consideration. Please refer to the specific section of the consolidated financial statements for a description of the primary differences between US GAAP and Dutch GAAP.

## Proposed distribution to shareholders

Pursuant to article 38 of the Articles of Association, and with the approval of the Supervisory Board and the Meeting of Priority Shareholders, a proposal will be submitted to the General Meeting of Shareholders to make a distribution in cash to shareholders of EUR 0.36 per common share, the same as last year.



- **Best Q4 results ever: income from operations of 14.1%**
- **Quality of income improved due to tight cost control and better product mix**
- **Strong cash contribution**
- **Sales growth hampered by soft markets worldwide**
- **Continued market leadership**

## Sales

Sales at Lighting totaled EUR 4,845 million and were 5% lower than in 2001. Sales volume increased by 1%, while average prices were 3% lower. Luminaires in particular suffered from difficult market conditions, while Automotive & Special Lighting continued to show growth. Sales growth in Asia Pacific continued; Latin American sales levels remained weak. The market slowdown in Europe and North America adversely affected turnover.

## Income from operations

Income from operations totaled EUR 602 million, or 12.4% of sales, and was above the 11.4% of 2001, mainly due to focused marketing management, tight cost control and more volume in high-end products. The 2002 result included net restructuring charges of EUR 13 million for various activities in the Netherlands, compared with EUR 16 million the year before.

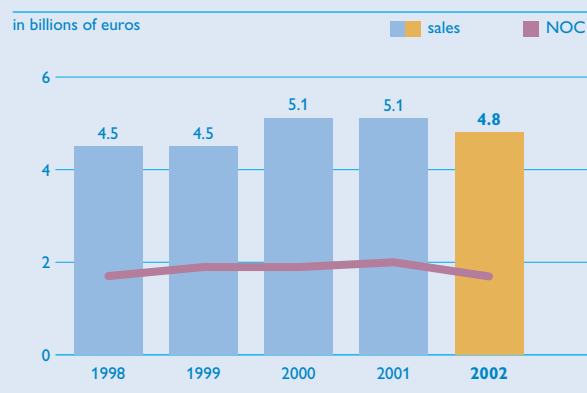
## Net operating capital

Lighting showed decreased net operating capital at the end of 2002, mainly due to lower receivables and inventories.

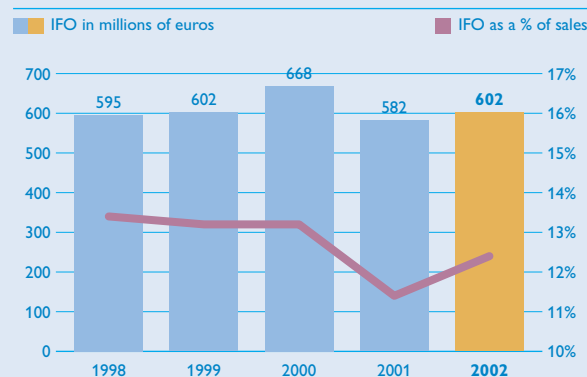
## Unconsolidated companies

In the LumiLeds Lighting 50/50 joint venture, Philips and Agilent have continued to strengthen the product portfolio of light-emitting diodes (LEDs), one of the key technologies which will drive the lighting business in the future.

## Lighting sales and net operating capital (NOC)

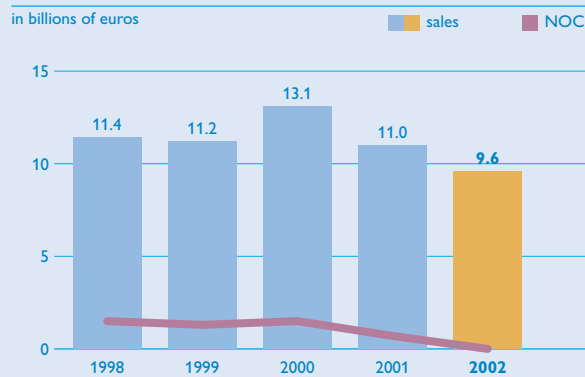


## Lighting income from operations (IFO)

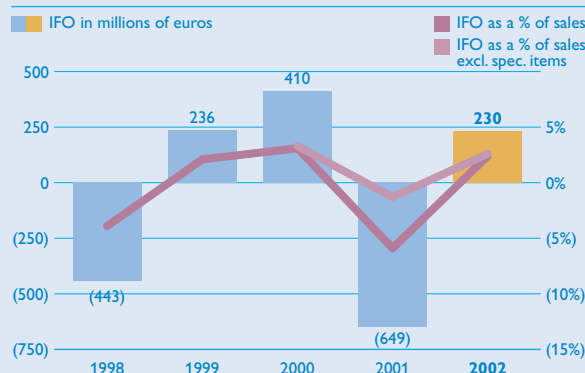


- **DVD+RW sales doubled and standard continues to gain market share**
- **Improved earnings in television and audio; monitor markets still highly competitive**
- **USA situation improved, not yet profitable**
- **Lower licensing income**
- **Refocused strategy for Digital Networks led to cost reductions**
- **PCMS divested**

## Consumer Electronics sales and net operating capital (NOC)



## Consumer Electronics income from operations (IFO)



## Sales

Sales in the Consumer Electronics sector (CE) decreased by 13% compared with 2001. A large part of the reduction (5%) is due to the shift of former CE activities to the sector Miscellaneous. In addition, weaker currencies (3%) and price erosion (10%) put pressure on sales. Sales volume grew by 5%. In Europe, CE performed very well, while the performance in the USA improved compared with 2001. Television improved, driven by the introduction of PixelPlus and the extension of the Flat TV product range. DVD, including DVD+RW, showed double-digit growth, taking share from the VCR business. The monitor markets experienced a severe price decline, especially in the second half of 2002. The measures taken in 2001 to rescale both GSM and Digital Networks had a negative effect on sales. For the second year in a row, the market for set-top boxes showed a decline (33% in 2002, compared with 9% in 2001).

## Income from operations

Income from operations at Consumer Electronics increased dramatically compared with 2001, returning to the black. The main improvements came from TV, audio, VCR and set-top boxes. The latter, however, was not yet profitable. The sale of our PCMS activities resulted in a gain of EUR 83 million. Net restructuring charges in 2002 amounted to EUR 100 million, of which EUR 96 million related to PCMS. License income in 2002 decreased to EUR 188 million, a decline of EUR 163 million compared to 2001. The 2001 figure included an amount of EUR 82 million of one-time payments for past use, considerably higher than the past-use payments received in 2002. The decline was also attributable to the expiration of basic CD patents in certain regions, which was only partly offset by increased income from our DVD and CD-R/RW licensing programs. The lower us dollar had a negative impact on income.

## Net operating capital

CE is continually reducing the asset base required to support its business operations through optimized supply chain management, an ODM (Original Design Manufacturing) business model philosophy and outsourcing. In the year under review this resulted in net operating capital of virtually zero.

# Domestic Appliances and Personal Care

- **Another record-breaking year for sales and income**
- **Increased profitability driven by cost management and product mix**
- **Strong position for Sonicare in the USA; starting to grow in Europe**

## Sales

Sales increased by 2%. After adjustment for currency effects, sales increased by 6%, comprising 8% volume growth offset by 2% lower prices. The expansion was above the market growth, due to a number of exciting innovations in the various markets coupled with successful regional market penetration (Senseo, Sonicare toothbrush, the new Sensotec shaver). Repositioning of the shaver range in North America had a positive effect on market share. The Senseo attained the number one position in all countries where it is available.

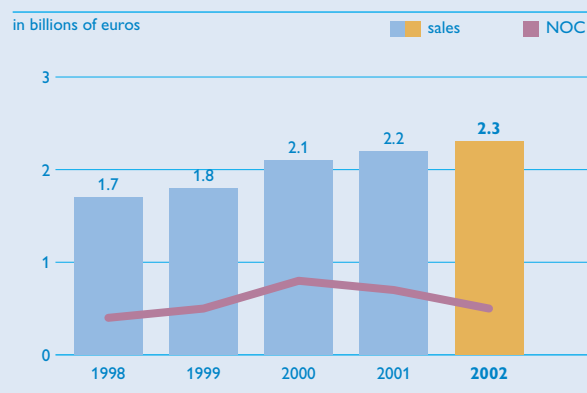
## Income from operations

Income from operations increased strongly by 20% to a new record high level of EUR 401 million, compared with EUR 334 million in 2001. The improvement was driven by sales expansion, margin improvement due to a better product mix and successful cost reduction programs. The profitability improvement was particularly visible in the businesses Oral Healthcare and Food & Beverage. Restructuring charges in 2002 amounted to EUR 9 million.

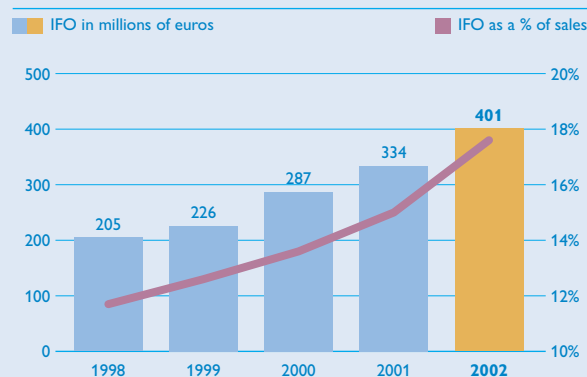
## Net operating capital

Net operating capital decreased considerably on a comparable basis. Strong focus on efficient utilization of capital reduced working capital by 13% in 2002 compared to 2001. With increasing sales, the turnover rate came to 4.3 at the end of 2002, up from 3.5 in 2001.

## DAP sales and net operating capital (NOC)

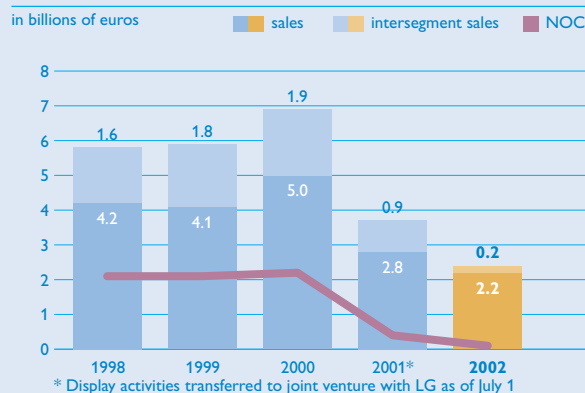


## DAP income from operations (IFO)

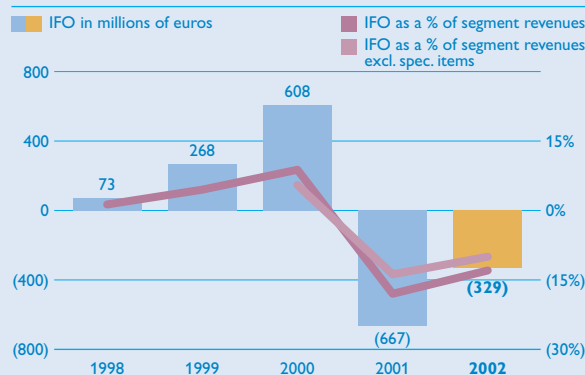


- **Components division dissolved January 1, 2003 to realign businesses and enhance synergies**
- **Restructuring charges of EUR 165 million; Optical Storage (Data) strongly downsized**
- **Sales growth driven by Mobile Display Systems; market share increased by 7%**
- **Improvement over 2001; not yet profitable**

## Components sales and net operating capital (NOC)



## Components income from operations (IFO)



## Sales

Components' sales totaled EUR 2,212 million for the year 2002, a decline of 20% in nominal terms largely due to the deconsolidation of Display Components, which was transferred to the LG.Philips Displays joint venture in mid-2001. Sales volume increased by 21%, while average prices declined by 11%. On a comparable basis, sales increased by 10% from 2001.

Mobile Display Systems recorded strong growth, attributable to an expanding display market and leading to a 7% increase in market share. Sales volume grew by more than 10%. The transition to color screens is being executed successfully, and revenues from color displays were reaching close to 45% by the end of the year.

Optical Storage recorded positive sales growth in spite of overcapacity in the industry caused by disappointing PC markets. Price erosion intensified, especially in the commoditized data segment. Philips took the decision to restructure and to remodel this business. The Audio/Video and Automotive business lines will be continued. In Emerging Electronic Solutions, sales grew marginally from 2001, mainly in Sound Solutions. However, performance was weaker in the tuners and remote controls businesses.

## Income from operations

Income from operations in 2002 came to a loss of EUR 329 million, which included special charges amounting to EUR 85 million for the full year. Income from operations, excluding special items, increased by EUR 266 million from 2001 and was mainly visible in Mobile Display Systems. The improved product mix and shift towards integrated modules had a positive effect on margins as well. Most of the innovative businesses in the Digital Displays cluster are in the early stage of the life cycle, with high R&D and capital expenditures impacting the profitability of this segment. The most significant special items were the charges taken for Optical Storage to exit the data segment (EUR 104 million) and the charges related to the dissolution of the product division (EUR 78 million).

## Net operating capital

Net operating capital was reduced due to inventory reduction, several asset write-downs and restructuring provisions.

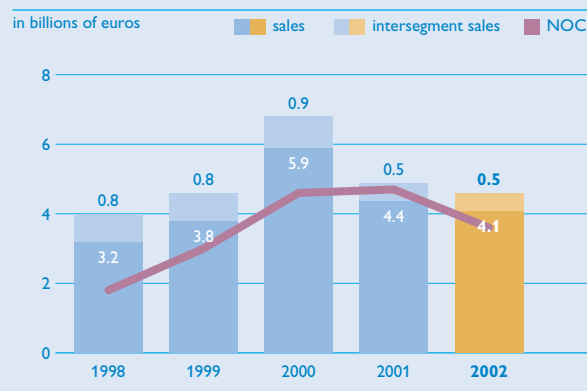


- **Another weak year for the industry, following a dramatic 2001; channel inventories cleared**
- **Distribution restocking in first half of 2002**
- **PC and mobile phone markets still depressed; continued overcapacity**
- **Rationalization of manufacturing capacity by closing of production lines**

## Sales

After experiencing the worst downturn in semiconductor history in 2001, markets more or less stabilized in 2002. For the second year in a row Semiconductors showed a nominal sales decline in 2002, this time by 7%. The decline was experienced across all businesses and consisted of a 7% increase in sales volume, a 3% decline due to currency movements and an 11% decrease due to price erosion. On a total available market (TAM) basis, market share declined by 0.1% to 3.1% (Source: WSTS). Saturation in the PC and handset markets and a weak financial position of telecom operators and service providers had an adverse effect on semiconductor industry growth. Semiconductors maintained its position in the profitable analog markets.

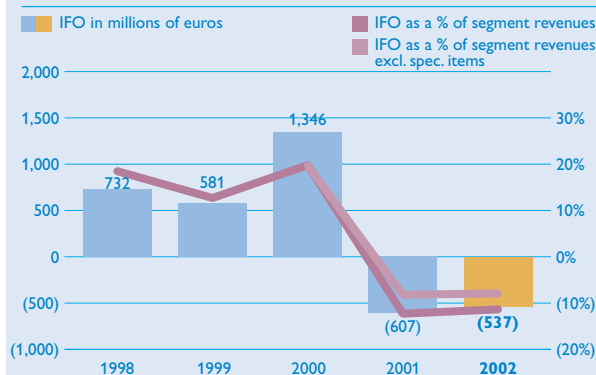
## Semiconductors sales and net operating capital (NOC)



## Income from operations

The year 2002 was yet another weak year for the industry. An initial improvement in the first half of the year due to reloading of the inventory channels was not sustained in the second half of the year. Coupled with inventory reductions by our own organization, this resulted in a still loss-making 54% wafer fab utilization. Expressed as a percentage of segment revenues, income from operations was a loss of 11.6%. Losses were incurred in growth areas such as digital consumer and networking as a result of continued substantial R&D efforts. Excluding net special charges of EUR 162 million, income from operations was a negative EUR 375 million. To reduce overcapacity, it was decided to further downscale production capacity by closing the fab in Albuquerque; this closure will be completed towards the end of 2003. R&D activities and overheads were further streamlined. The total cost of these measures was EUR 169 million in 2002. A further EUR 66 million will be recognized in 2003. The wafer capacity restructurings announced over the last two years will reduce capacity by 15%.

## Semiconductors income from operations (IFO)

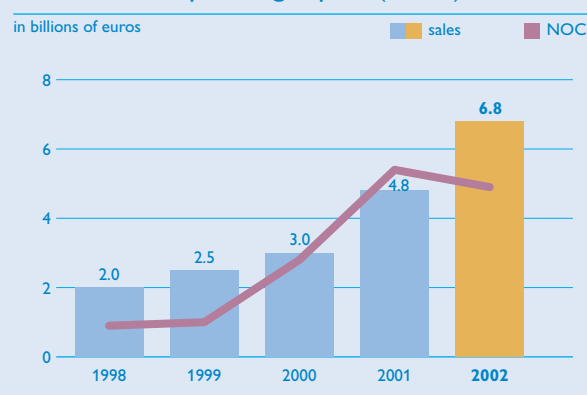


## Net operating capital

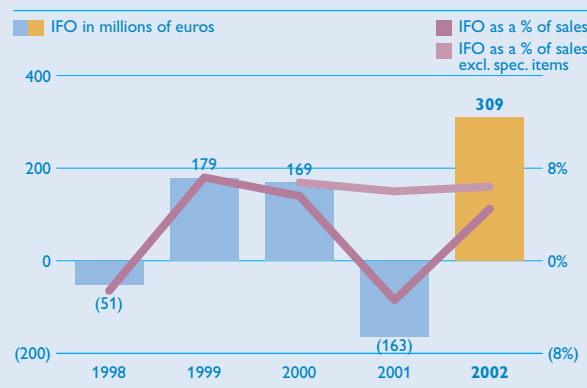
Capital expenditures were reduced as much as possible. To further limit our exposure to capital commitments, cooperation with TSMC, SSMC and STMicroelectronics will be continued, including a joint 12-inch pilot fab that is being built with STM and Motorola, which is expected to be operational in 2003.

- Sales growth of 5% excluding acquisitions
- Market position reinforced
- Savings through integration synergies on track despite IT setbacks
- Improved performance of X-ray, Customer Service and Computed Tomography/Magnetic Resonance (CT/MR)

## Medical Systems sales and net operating capital (NOC)



## Medical Systems income from operations (IFO)



## Sales

Sales at Medical Systems in 2002 totaled EUR 6,844 million, representing 42% growth, mainly attributable to the effect of the acquisitions (41%). Currency movements had a negative impact of 4%. Sales volume increased by 8%, while average prices declined by 3%. X-ray, Computed Tomography, Nuclear Medicine, Cardiac and Monitoring Systems and Customer Support drove the sales increase. From a regional perspective, sales growth was strongest in North America.

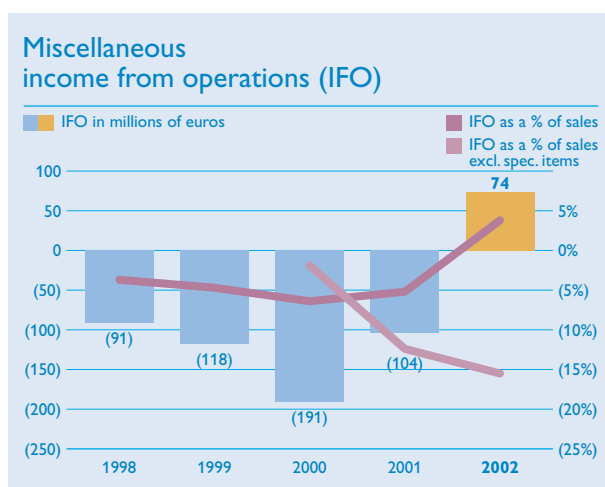
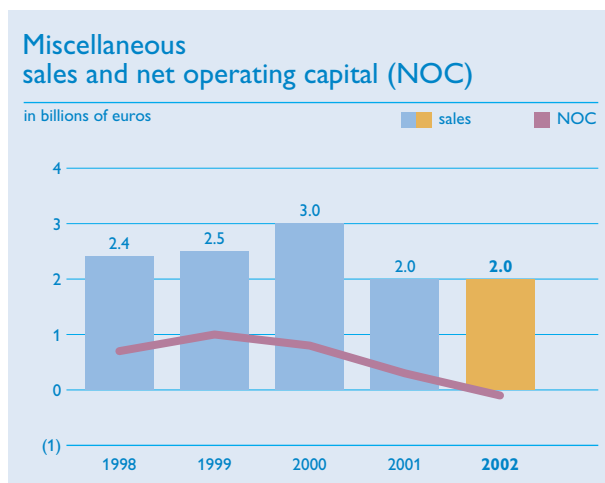
## Income from operations

Income from operations in 2002 included special charges of EUR 126 million, including acquisition-related costs of EUR 84 million and impairment charges for Health Care Products (HCP) amounting to EUR 47 million. Excluding these special items and 2001 amortization of goodwill, income from operations in 2002 improved by EUR 40 million to a record EUR 435 million. This increase mainly came from the improved sales and performance of X-ray, Customer Service and CT/MR.

There were also a number of non-recurring charges totaling EUR 73 million, mainly following the Marconi and Agilent acquisitions, and charges taken for the exposure related to Argentina. In addition, IT costs were EUR 58 million higher than in 2001, due to the new IT configuration in the acquired companies. Despite a delay and the relatively high cost of integrating IT systems, the integration of the new acquisitions and the related restructuring program are on schedule. Positive synergy effects in 2002 amounted to EUR 173 million. The integration is expected to yield significant savings of EUR 350 million during the full year 2003.

## Net operating capital

Net operating capital was significantly lower due to the weaker dollar and the sale of HCP.



**Corporate & regional overheads: key data**

in millions of euros

	2000	2001	2002
Corporate and regional overheads	(495)	(411)	(332)
Pensions / post-retirement benefit costs	393	290	2
Income from operations	(102)	(121)	(330)
Number of employees (FTEs)	6,388	5,463	4,315

## Corporate Investments

Our low-growth low-return divestment program continued successfully despite poor M&A markets. Income from operations was positively impacted by the sale of TechnoFusion, SMATV, Heat and Surface Treatment, Philips Broadband Networks, Analytical and CSI, resulting in a gain of EUR 245 million. Furthermore, an earn-out of JDS Uniphase shares lifted income by EUR 113 million. Moreover, income improvements were recorded at Assembléon.

## Intellectual Property & Standards

In 2002 the slowdown of the world economy, currency effects and the expiration of patents negatively impacted revenues. However, this was partly offset by revenues from new licensing programs, e.g. in respect of digital audio and video compression technologies. Moreover, the increased efforts to enforce our intellectual property rights against companies that use our technology and to force companies to comply with existing licenses started to bear fruit. Significant efforts are being devoted to establishing the standards for the next generation of high-density optical storage technology and to launching systems for protecting and securing the distribution of digital audio and video content.

## Research

In 2002, expenditures for R&D activities, which are mainly concentrated in Semiconductors followed by Medical Systems, amounted to EUR 3,043 million, representing 9.6% of Group sales, compared to EUR 3,312 million, or 10.2% of Group sales, in 2001.

## Corporate & Regional Overheads

The costs of the corporate center – including the Company's initial funding of e-business and global brand management programs – as well as country and regional overhead costs are not attributable to the product sectors, but are reported separately under the sector Unallocated. Income from operations amounted to a loss of EUR 330 million, compared to a loss of EUR 121 million in 2001.

A sharp decrease in group overheads in 2002 was more than offset by significantly higher pension costs.

## Outlook

Through operational and marketing excellence, we expect that the DAP and Lighting divisions will again outperform their industries in 2003, whilst Consumer Electronics is continuing to improve its overall performance, especially in the USA, through a marketing focused approach and innovative product mix. The integration of our Medical Systems division is on track to achieve the targeted EUR 350 million in savings by year-end. Semiconductors is lowering the break-even point as a result of capacity reduction and restructuring savings. Restructuring programs undertaken by Philips during the past two years are starting to pay off with more profitable, efficient and less capital-intensive operations.

The Company will continue cost reduction initiatives, including the reduction in overhead costs, which is on track, and ongoing supply-chain management, which has reached best-in-class in a number of businesses, especially Consumer Electronics.

Continued weakness of the US dollar would negatively impact sales and to a lesser extent net income, whilst volatile stock markets can significantly impact pension expense and the value of financial assets of the Company.

On the basis of the current economic and political uncertainties, Philips does not anticipate any short-term improvement in economic conditions. As such, the Company will continue its cautious stand on costs, capital spending, working capital and employment, whilst maintaining a strong balance sheet and remaining ready for any upturn in its markets.

February 7, 2003

*Board of Management*



### Business Principles

The Philips General Business Principles 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 on which all Philips activity is or should be based: integrity, fair trade, non-discrimination and equal opportunities. The General Business Principles have been translated into the local language in almost all countries. In most countries they are now an integral part of the labor contract. In the countries where this is not the case, the employees sign a document confirming that they have received a copy of the General Business Principles. In order to further heighten awareness of the issue of business ethics, our casebook for dilemma training has been updated and expanded.

The responsibility for compliance with the Principles rests first and foremost with the management of the business. In every product division and country organization a Compliance Officer has been appointed. The Philips Intranet provides information on how to contact the Compliance Officer. Our program – building upon long-standing practice in the USA – to introduce guaranteed-anonymity hotlines for reporting of suspected contraventions of the General Business Principles passed a new milestone with the roll-out to the entire Latin American region.

With a view to ensuring maximum transparency for shareholders and other interested parties, a section of our Internet site ([www.investor.philips.com](http://www.investor.philips.com)) is devoted to specific issues of business ethics, such as political payments, military and defense contracts, and child labor. With regard to the latter, an extensive inventory of group companies has confirmed that Philips does not employ child labor. In 2002 this inventory was extended to major sub-contractors and suppliers in high-risk regions. We have asked Nyenrode University of the Netherlands to assist us in developing a blueprint for an improvement plan that could be imposed upon suppliers or sub-contractors who do not fulfill the criteria laid down in ILO Conventions 138 and 182. To ensure full awareness of and compliance with the highest standards of transparency and accountability

by all employees performing important financial functions, and in view of the recent US legislation in respect thereof, Philips is preparing a financial code that will contain, among other things, standards to promote honest and ethical conduct and full, accurate and timely disclosure procedures to avoid conflicts of interest, as well as a procedure for whistleblowers to report potential issues. All employees performing important financial functions will have to confirm adherence to the financial code, which is expected to be introduced in the first half of 2003.

### Sustainability

Philips is committed to sustainable growth. We recognize the need to perform not only against a single financial bottom line, but also against the triple bottom line. This involves the simultaneous pursuit not only of economic prosperity and environmental quality, but of social equity as well. It's about living up to our brand promise *Let's make things better*.

At Philips, we view sustainability in terms of overall corporate responsibility – economic responsibility, environmental responsibility, personal responsibility (to our employees) and social responsibility (to our customers, the local communities in which we operate and society at large).

The newly created Sustainability Board – chaired by a member of the Board of Management and comprising representatives of the relevant functional disciplines – provides governance on the issue of sustainability and acts as an advisory body to the Group Management Committee.

In addition to the environmental reporting already in place, we have begun measuring and reporting on our health & safety performance around the world. Both sets of results are presented in the separately published Philips Sustainability Report 2002 – the next step towards comprehensive sustainability reporting and an indication of our commitment to extend the dialogue with our stakeholders.

### Corporate Governance

Being a global company and player in the international capital markets, Philips has, over the last decades,

continuously improved its corporate governance as one of its most important policy items in line with US, Netherlands and international codes of best practises. The governance of the Company and the Philips Group was improved substantially, in particular by simplifying its corporate structure and making it more transparent and by strengthening the accountability of the Board of Management as its executive management and the Supervisory Board as its board of independent supervisory directors, as well as by increasing the rights and powers of its shareholders and communication with investors. In this respect, the consequences for the Company of the US Sarbanes-Oxley Act and the proposed amendments to the listing rules of the New York Stock Exchange were discussed and existing procedures reviewed and, where appropriate in response to these regulations currently effective, changes effected and formalized. The Company also disclosed its Policy on Auditor Independence, aligned with the new regulations to the extent currently effective. Furthermore, the Company made necessary preparations in view of the CEO and CFO certifications for the 2002 Annual Report on Form 20-F with the US Securities and Exchange Commission. This certification process for Form 20-F (which incorporates parts of this Annual Report) under US law is in addition to the Dutch legal provisions according to which each member of the Supervisory Board and the Board of Management has signed the 2002 financial statements for approval.

### **Proxy solicitation**

Philips attaches great value to its relations with its shareholders. For instance, Philips was one of the key companies in the establishment of the Shareholders' Communication Channel – a project of Euronext Amsterdam, banks in the Netherlands and several major Dutch companies to simplify contacts between a participating company and its shareholders.

Philips will use the Shareholders' Communication Channel to distribute the Management Report booklet of its Annual Report and the Agenda for this year's General Meeting of Shareholders as well as an instruction form to enable proxy voting at said Meeting.

For the General Meeting of Shareholders on March 27, 2003 a record date (being March 20, 2003) will apply: those persons who on March 20, 2003 hold shares in the Company and are registered as such in one of the registers designated by the Board of Management for the General Meeting of Shareholders will be entitled to participate and vote at the Meeting.

# Board of Management



**Gerard Kleisterlee** 1946, Dutch

**President/CEO and Chairman of the Board of Management and the Group Management Committee President/CEO and Chairman of the Board of Management since April 2001; member of the Board of Management since April 2000; member of the Group Management Committee since January 1999**

After graduating in electronic engineering at Eindhoven University of Technology, Gerard Kleisterlee started his career with Philips in 1974 at Medical Systems. In 1981 he became general manager of Professional Audio Systems. In 1986 he joined Philips Components, and after becoming general manager of Philips Display Components for Europe, he was appointed managing director of Philips Display Components worldwide in 1994. He became president of Philips Taiwan and regional manager for Philips Components in Asia Pacific in 1996. He was also responsible for the activities of the Philips Group in China from September 1997 to June 1998. From January 1999 to September 2000 he was President/CEO of Philips Components.



**Jan Hommen** 1943, Dutch

**Vice-Chairman of the Board of Management and Chief Financial Officer**

**Vice-Chairman of the Board of Management since April 2002; member of the Board of Management and the Group Management Committee and Chief Financial Officer since March 1997**

Jan Hommen studied business economics at Tilburg University, before beginning his career as controller at Lips Aluminium in Drunen (The Netherlands) in 1970. This company was taken over by Alcoa in 1975, whereupon he became financial director of Alcoa Nederland. In 1978, Jan Hommen moved to Alcoa's head office in Pittsburgh, USA, as assistant-treasurer; becoming vice-president and treasurer in 1986 and executive vice-president and chief financial officer in 1991.



**Arthur van der Poel** 1948, Dutch

**Executive Vice-President**

**Member of the Board of Management since May 1998; member of the Group Management Committee since May 1996**

Arthur van der Poel graduated in telecommunications engineering at Eindhoven University of Technology and began his career with the Dutch PTT. He joined Philips in 1984 and became a director of the Semiconductors division (responsible for the Consumer ICs business group) in 1991. Three years later he was appointed managing director of the Consumer ICs business group. He was CEO of Philips Semiconductors from 1996 until 2001.



**Ad Huijsen** 1946, Dutch

**Executive Vice-President and Chief Technology Officer Member of the Board of Management since April 2002; Chief Technology Officer since May 2001; member of the Group Management Committee since April 1999 and CEO of Philips Research since 1998**

After graduating from Eindhoven University of Technology, Ad Huijsen gained a Ph.D. in applied physics from the University of Twente. He joined Philips in 1970 and held various positions in the Research Laboratories before becoming chief technology officer for the Consumer Electronics division in 1991. A year later he became managing director of R&D for the Television business group. In 1994 he returned to the Research Laboratories as managing director and chairman of the management committee, and in 1996 he was appointed senior adviser and director of Philips Multimedia Center in California.



**Gottfried Dutiné** 1952, German

**Executive Vice-President**

**President/CEO of the Consumer Electronics division since January 2003; member of the Board of Management since April 2002; member of the Group Management Committee since February 2002**

Gottfried Dutiné holds a degree in electrical engineering and a Ph.D. in communications technology from the University of Darmstadt, Germany. He began his career at Rockwell-Collins in Frankfurt, where he was appointed director of engineering. In 1984 he joined Motorola, and in 1989 he went to Robert Bosch, where he held several positions before leaving for Alcatel in Paris at the end of 1997. At Alcatel he was appointed vice-president of the Telecom Board Committee and area president for Central & Eastern Europe and Russia.

# Group Management Committee

The Group Management Committee (GMC) is composed of the Board of Management and the following senior officers:



**Ad Veenhof** 1945, Dutch

**Member of the GMC since January 1996 and President/CEO of the Domestic Appliances and Personal Care division since 1996**

Ad Veenhof studied business administration at Nyenrode University and economics at Groningen University. He joined Philips in 1971. Having held various positions in the Netherlands, he moved to the Video division in 1983, becoming corporate project leader for LCD products in 1986 and, three years later, also for high-definition television within Consumer Electronics. In 1992 he was appointed a managing director of the division, with responsibility for the Video Equipment business. From September 1992 he was also chairman of iR3 Video International, the Philips/Grundig joint venture.



**Tjerk Hooghiemstra** 1956, Dutch

**Member of the GMC since April 2000; responsible for Human Resources Management since 2000**

Tjerk Hooghiemstra graduated in economics from Erasmus University in Rotterdam in 1982. He spent three years with the Amro Bank before joining the Hay Group in 1986, becoming a member of its European Executive Board and a partner of the Hay Group Exempted Partnership. Joining Philips in 1996, he was appointed managing director of HRM for the Consumer Electronics division.



**Scott McGregor** 1956, American

**Member of the GMC since January 2002 and president/CEO of the Semiconductors division since 2002**

Scott McGregor holds a B.A. in psychology and an M.Sc. in computer science and computer engineering from Stanford University. He joined Philips Semiconductors in 1998 with responsibility for the newly created unit Emerging Businesses, focusing on creating fast-growing markets such as smart cards, networking, digital media processing and computing. Prior to joining Philips, he held senior management positions at the Xerox Palo Alto Research Center, Microsoft, Digital Equipment and SCO.



**Guy Demuyne** 1951, Belgian\*

**Member of the GMC since April 2000 and President/CEO of the Consumer Electronics division since 2000**

Guy Demuyne obtained degrees in applied economics and marketing from the Universities of Antwerp and Gent respectively. He joined Philips Audio in 1976, holding a number of positions within the division up to January 1992. He then became chief executive officer of Philips Korea, but returned to Audio 18 months later to head its global Portable Audio activities. The Hi-Fi business, Marantz and a number of related businesses were added in 1997 to form the Audio business group within Consumer Electronics.

\* Mr Demuyne left the Company as of January 1, 2003.



**Arie Westerlaken** 1946, Dutch

**Member of the GMC since May 1998, Secretary to the Board of Management since 1997 and Chief Legal Officer since 1996**

Arie Westerlaken graduated in law from the University of Utrecht. He joined Philips' legal department in the Netherlands in 1973 and was appointed general counsel to Philips Japan in 1979. After six years in Japan and five years with the Corporate Legal Department in Eindhoven, he left Philips in 1990 to become director of legal affairs at DAF Trucks. Returning to Philips in 1994, he was appointed director of legal affairs.



**Jouko Karvinen** 1957, Finnish

**Member of the GMC since October 2002 and President/CEO of the Medical Systems division since 2002**

Jouko Karvinen holds an M.Sc. in electronics and industrial economics from Tampere University of Technology in Finland. Before joining Philips in 2002, he was responsible for the Automation Division of ABB Group Ltd. and was a member of the ABB Group Executive Committee. Jouko Karvinen also served ABB Group in several international positions, with business responsibilities in marketing and sales, project management and operations. He has extensive experience in integrating businesses after acquisitions.



**Jan Oosterveld** 1944, Dutch

**Member of the GMC since May 1998; responsible for Corporate Strategy since 1997**

Jan Oosterveld studied mechanical engineering and factory automation at Eindhoven University of Technology and achieved an MBA at the Instituto de Estudios Superiores de la Empresa in Barcelona. He joined Philips in 1972 and held a variety of senior management positions in Spain and the Netherlands, before becoming R&D and industrial director of the VCR business in 1983. Appointed a director in 1984, Jan Oosterveld founded Philips Key Modules in 1989. He was appointed a managing director in 1995.



**David Hamill** 1957, British

**Member of the GMC since May 2001 and President/CEO of the Lighting division since 2001**

David Hamill graduated from Strathclyde University with an honors degree in production engineering and management. After working for Honeywell, General Instruments and STC, he joined Philips Semiconductors in 1986. In 1993 he was appointed senior vice-president of Philips Lighting Asia Pacific (responsible for its activities in China/Hong Kong), becoming president in 1996. David Hamill was appointed executive vice-president of Philips Lighting and CEO of the Lamps business group in 1998 and chairman of the Lumileds Board in 1999.



## Supervisory Board



**L.C. van Wachem** 1931, Dutch\*\* \*\*\*

Chairman  
Member of the Supervisory Board since 1993; third term expires in 2005  
Former Chairman of the Committee of Managing Directors of the Royal Dutch/Shell Group and former Chairman of the Supervisory Board of Royal Dutch Petroleum Company. Former member of the Supervisory Boards of Akzo Nobel, Bayer and BMW and of the Board of IBM. Currently chairman of the Board of Directors of Zürich Financial Services and member of the Board of Directors of ATCO



**W. de Kleuver** 1936, Dutch\* \*\*\*

Vice-Chairman and Secretary  
Member of the Supervisory Board since 1998; second term expires in 2006  
Former Executive Vice-President of Royal Philips Electronics



**J.M. Hessels** 1942, Dutch\*

Member of the Supervisory Board since 1999; first term expires in 2003  
Former Chief Executive Officer of Royal Vindex KBB and currently Chairman of the Supervisory Board of Euronext and member of the Supervisory Boards of Laurus, Amsterdam Schiphol Group, Royal Vopak, Heineken, Barnesandnoble.com and Fortis



**Prof. K.A.L.M. van Miert** 1942, Belgian\*

Member of the Supervisory Board since 2000; first term expires in 2004  
Former Vice-President of the European Commission and currently President of Nyenrode University, member of the Supervisory Boards of Wolters Kluwer, RWE, DHV, Agfa Gevaert, De Persgroep, Fraport, Munich and Anglo American



**L. Schweitzer** 1942, French

Member of the Supervisory Board since 1997; second term expires in 2005  
Chairman and Chief Executive Officer of Renault, President of Renault-Nissan and member of the Boards of BNP Paribas, Electricité de France and Volvo



**Sir Richard Greenbury** 1936, British\*\*

Member of the Supervisory Board since 1998; second term expires in 2006  
Former Chairman and Chief Executive Officer of Marks & Spencer and former director of Lloyds TSB, British Gas, ICI and Zeneca, and currently member of the Board of Electronics Boutique Plc.

\* Member of the Audit Committee

\*\* Member of the Remuneration Committee

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

## General

The oversight of the policies and actions of the executive management (the Board of Management) of the Company is entrusted to the Supervisory Board, which, in the applicable two-tier structure of Netherlands law, is a separate body and completely independent from the Board of Management. This independency is also reflected in the requirement that members of the Supervisory Board be neither a member of the Board of Management, nor an employee of the Company.

The Supervisory Board, acting in the interests of the Company and the Philips Group, supervises and advises the Board of Management in performing its management tasks and setting the direction of the Group's business.

The Supervisory Board is empowered to recommend persons to be appointed as members of the Supervisory Board or the Board of Management to the General Meeting of Shareholders. Major management decisions, including the Group strategy, require the approval of the Supervisory Board. The Supervisory Board determines the remuneration of the members of the Board of Management.

Regarding the worldwide developments in the field of corporate governance, in 2002 the Supervisory Board discussed the possible consequences for the Company of the US Sarbanes-Oxley Act and the proposed amendments to the listing rules of the New York Stock Exchange several times. The Company has reviewed its existing system of internal business controls and, where appropriate, formalized or modified some procedures previously adhered to. The Supervisory Board has also updated its 'Rules of Procedure', containing its own governance rules and the charters of the three permanent committees that advise the full Board on certain matters. The Rules of Procedure have been published on the Company's Internet website. The same is true of the Policy on Auditor Independence, which has been aligned to the new regulations. In light of the proposed changes to the NYSE listing rules, the Supervisory Board has also decided to designate the existing Nomination and Selection Committee as a corporate governance committee (under the new name 'Corporate Governance and Nomination & Selection Committee'). The Corporate Governance and Nomination & Selection Committee will review the corporate governance principles applicable to the Company at least once a year, and will advise the Supervisory Board on any changes to these principles as it deems appropriate.

The other permanent Supervisory Board Committees are the Remuneration Committee and the Audit Committee.

## Meetings of the Supervisory Board

The Supervisory Board met six times in the course of 2002, including a two-day meeting on strategy. The members of the Board of Management were present at the meetings of the Supervisory Board except in matters regarding the composition of the Supervisory Board, the Board of Management and the Group Management Committee, as well as the remuneration and performance of members of the Board of Management and the Group Management Committee. During the course of the year the Supervisory Board was informed and consulted by the Board of Management on the course of business, important decisions and the Philips Group strategy. In addition to the scheduled meetings, the Chairman of the Supervisory Board had regular contact with the President/CEO throughout the year.

## Composition and remuneration of the Supervisory Board

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

The Supervisory Board currently consists of six members. At the General Meeting of Shareholders held on March 28, 2002 Messrs W. de Kleuver and Sir Richard Greenbury were re-elected. At the 2003 General Meeting of Shareholders the present term of Mr J.M. Hessels shall end. In view of the knowledge, experience and contribution he brings to the Board and in particular given his role as Chairman of the Audit Committee, we, in agreement with the Meeting of Priority Shareholders, will make a proposal at the General Meeting of Shareholders to be held on March 27, 2003 to re-elect Mr Hessels.

In agreement with the Meeting of Priority Shareholders, we will also make a proposal at the 2003 General Meeting of Shareholders to elect Messrs J.M. Thompson and

C.J.A. van Lede to the Supervisory Board as from April 1, 2003. Mr Thompson (1942) held a variety of management positions in IBM from 1966. Until September 2002 he was Vice-Chairman of the Board of Directors, in which capacity he oversaw IBM's worldwide strategy, with specific focus on developing IBM's leadership in important emerging marketplaces. Considering Mr Thompson's knowledge and experience of the business the Company is in, as well as his international experience, the Supervisory Board recommends to the General Meeting of Shareholders to adopt the proposed appointment. The same applies to the proposed appointment to the Supervisory Board of Mr Van Lede (1942). He is currently Chairman of the Board of Management of Akzo Nobel, which company he joined in 1991; Mr Van Lede will retire from this position on May 1, 2003. He has held management positions in various companies and is the former Chairman of the Federation of Netherlands Industries. Besides his managerial business experience, the Supervisory Board bases its recommendation to the General Meeting of Shareholders to appoint Mr Van Lede as a member of the Supervisory Board on his experience with international business organizations.

In 2002 the statutory age limit for members of the Supervisory Board was abolished under Dutch law. As a consequence, the age limit of 72 years as provided for in the Articles of Association of the Company no longer applies. We are pleased that our Chairman, Mr Van Wachem, will thus be able to continue his membership of our Board and also is willing to do so.

The remuneration of the members of the Supervisory Board is determined by the General Meeting of Shareholders of the Company. The Supervisory Board determines the additional remuneration for its Chairman and the members of its committees. Since 1998 the remuneration has been EUR 40,840 per year for members of the Supervisory Board and EUR 74,874 for the Chairman. For each committee membership the remuneration is EUR 4,538 per year; details are disclosed on pages 98 and 99 of the separate booklet entitled 'Financial Statements and Analysis'.

### Selection and nomination of members of the Supervisory Board, the Board of Management and the Group Management Committee

The Supervisory Board and the Meeting of Priority Shareholders jointly recommend individuals to be elected by the General Meeting of Shareholders as members of the Supervisory Board and of the Board of Management. Under

its Rules of Procedure, the Supervisory Board appoints members of the Group Management Committee who are not members of the Board of Management. All such resolutions are adopted upon the advice of the Corporate Governance and Nomination & Selection Committee consisting of the Chairman, Vice-Chairman and Secretary of the Supervisory Board (ex officio).

Mr J.W. Whybrow retired as Executive Vice-President and member of the Board of Management on April 1, 2002. At the General Meeting of Shareholders on March 28, 2002 Messrs A. Huijser and G.H. Dutiné were appointed as members of the Board of Management and Executive Vice-Presidents effective April 1, 2002. In addition to his responsibilities as Chief Financial Officer, the Supervisory Board has appointed Mr J.H.M. Hommen as Vice-Chairman of the Board of Management effective April 1, 2002.

Messrs S. McGregor, J. Karvinen and A. Ragnetti have been appointed as members of the Group Management Committee and Senior Vice-Presidents effective January 1, 2002, October 1, 2002 and January 1, 2003 respectively.

Mr J.M. Barella retired as a member of the Group Management Committee and Senior Vice-President as of October 1, 2002. With effect from November 1, 2002, Mr M.T. Medeiros, and effective January 1, 2003, Mr G.J.M. Demuynck resigned as members of the Group Management Committee to take up other interests outside the Company.

### Remuneration of the Board of Management

The remuneration of the members of the Board of Management is determined by the Supervisory Board on the advice of the Remuneration Committee of the Supervisory Board. The members of the Remuneration Committee are listed on page 58. The President is responsible for providing necessary benchmark information and proposals, except regarding his own remuneration, to the Remuneration Committee.

### General remuneration policies

The objective of the remuneration policy for members of the Board of Management is in line with that for Philips Executives throughout the Philips Group: to focus them on improving the performance of the Company and enhancing the value of the Group, to motivate and retain them, and to be able to attract other highly qualified executives to enter into Philips' service, when required.

In determining the remuneration policy, the Remuneration Committee ensures that a competitive remuneration package for Board-level executive talent is maintained and benchmarked with other multinational companies operating in global markets. For that purpose, benchmark research is carried out each year with Dutch and other European companies in the general industry of comparable size, complexity and international scope. Additional market data is provided by a number of independent external advisers. In the case of the appointment of non-European members of the Board of Management, the Remuneration Committee may apply a broader benchmark with non-European data.

In order to link executive remuneration to the Company's performance, the remuneration package includes a significant variable part in the form of an annual cash bonus incentive and a long-term incentive in the form of stock options. The total cash pay-out in any year is the sum of the received base salary in the year concerned and the bonus pay-out related to the previous year. For those current Board members who were also Board members on April 1, 2001, the total cash pay-out in 2002 decreased by 28% with regard to the year 2001.

#### Base salary

Base salaries are based on a function-related salary system. When first appointed, an individual Board member's base salary will usually be below the maximum function-related salary. Normally (and subject to the decision by the Supervisory Board) the base salary will reach the maximum function-related salary level over a 3-year period from appointment. In line with market developments shown by benchmark studies, the maximum function-related salary levels in 2002 have been increased by 2.5% compared with those of 2001. In 2002, the (maximum) function-related salary of the President/CEO was EUR 1,012,000 and that of the Vice-Chairman/CFO EUR 835,000; the (maximum) function-related salary of the other Board members was EUR 651,000. In 2002, the annual salary review period was brought in line with that of the Philips Executives. As a consequence of this decision, the annual review date for the base salary is set at April 1. Adjustment of individual salaries is influenced by the (annual) adjustment, if any, of the function-related salary levels and the progress to the (maximum) function-related salary level if this level has not yet been reached. The individual salary levels are shown in the table on page 96 of the separate booklet entitled 'Financial Statements and Analysis'.

#### Annual Incentive (bonus)

Each year, a variable cash bonus can be earned, based on the achievement of specific targets. Bonus targets are set at a challenging level, taking into account general trends in the relevant markets, and are partly (70%) linked to the financial result of the Philips Group and partly (30%) to the areas of responsibility monitored by the individual member of the Board of Management as a derivative of the set team targets. The bonus criteria are 1) the financial indicators of the Company: Cash Flow and Economic Profit Realized, and 2) team goals. The related targets for the members of the Board of Management are determined annually at the beginning of the year by the Remuneration Committee on behalf of the Supervisory Board and hence are linked to the Company's financial performance, as well as to the team targets.

In principle, the maximum cash bonus achievable is 90% of the annual base salary. The Remuneration Committee may decide to grant a higher bonus percentage if exceptional targets are met. The bonus pay-out in any year relates to the achievements of the preceding financial year versus agreed targets. As a result, bonuses paid in 2002 relate to the salary levels and the performance in the year 2001. Similarly, the bonuses payable in 2003 will be calculated on the basis of the 2002 annual results.

The Board of Management decided not to take the bonus pay-out in 2002. This decision was respected and accepted by the Supervisory Board with one exception. Mr J.W. Whybrow left the Company on April 1, 2002, and taking into account the considerable contribution he made to the Company, the Supervisory Board, on the advice of the President, granted a discretionary bonus for the year 2001 to Mr J.W. Whybrow in 2002.

#### Long-Term Incentive Plan (LTIP)

Subject to the approval of the Supervisory Board, Royal Philips Electronics equity-based incentive plans may be introduced for the Board of Management, Philips Executives, high-performing employees and other employees in key positions. The Supervisory Board also approves the plan-related maximum pool-size of the underlying equity as well as the respective terms and conditions. In 2002, stock options were granted to the members of the Board of Management under the approved Philips Stock Option Plan 2002 applicable to Philips Executives in general.

The number of stock options granted was dependent on the long-term performance of the Company relative to a defined group of peer companies throughout the preceding three years, as explained in our report in 2001. The Supervisory Board decided to grant the maximum number of stock options, given the relative Total Shareholder Return performance (position in the upper quintile of the list) during the period December 31, 1998 to December 31, 2001, as stated in the terms & conditions of the 2002 plan. For details of the 2002 plan, see pages 91-94 of the separate booklet entitled 'Financial Statements and Analysis'.

In 2000 and 2001, 50% of the granted stock options were awarded as fixed options and 50% as performance-related options, linked to the long-term Company performance relative to a defined group of peer companies. The Supervisory Board has decided to fix vesting (as of February 17, 2003) at 75% of the performance-related stock options 2000 given Philips' performance vis-à-vis the defined peer group (positioned in second top quintile of the list) during the observation period November 30, 1999 to November 30, 2002, as stated in the terms & conditions of the 2000 plan.

For 2003 the LTIP will be a combination of stock options and restricted shares. The introduction of restricted shares (vesting in three equal instalments over a period of three years), and hence the combination of stock options and restricted shares, is designed to lead to a compensation for Board of Management members, Philips Executives and high-performing professionals which remains linked to the change of the share price, but is less volatile than one that relies exclusively on stock options. To stimulate the holding of shares among the participants in the LTIP including (top) management of Philips, additional premium shares will be awarded if the shares are kept for a period of three years after each vesting date. The annual grant to members of the Board of Management and the Group Management Committee will be brought in line with those of the other grantees and therefore will shift to April 15, 2003 (i.e. Series 2). Although it is not a legal requirement to request shareholder approval for the proposed LTIP, against the background of the continuous endeavors to improve the Company's corporate governance the LTIP will be submitted to the General Meeting of Shareholders on March 27, 2003 for approval.

According to Philips' Rules of Conduct with respect to Inside Information, members of the Board of Management (and the other members of the Group Management Committee) are

only allowed to trade in Philips securities (including the exercise of stock options) during 'windows' of ten business days following the publication dates of annual and quarterly results (provided the person involved has no 'inside information' regarding Philips at that time).

#### Pensions

The pensions of members of the Board of Management are funded by the Stichting Philips Pensioenfond (the 'Philips Pension Fund') of the Netherlands. The conditions contained in the by-laws of the Philips Pension Fund apply, with the proviso that the pensionable age – from the point of view of pension accrual – has been set at 60. If the employment agreement of members of the Board of Management continues after the age of 60, the pension payments are postponed accordingly, as provided for in the Philips Pension Fund by-laws. As the retirement age is different from the date of commencement of the state pension, the pension scheme provides for a bridging payment in order to compensate for the adverse effect. The Board of Management members' own contribution comprises 4% of EUR 61,116 and 6% of the difference between the gross pensionable salary minus the franchise and the above-mentioned amount of EUR 61,116. A different arrangement resulting in additional pension benefits may apply in some cases as a result of past policies.

#### Additional arrangements

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

The Company's policy forbids personal loans to members of the Board of Management, and no loans have been granted to such members in 2002, nor are outstanding as of December 31, 2002.

#### Contracts of employment

Members of the Board of Management have a contract of employment with the Company. The form of contract used for members of the Board of Management is in line with the standard form used for other Philips Executives.

In the event of disablement, members of the Board of Management are entitled to benefits in line with those for other Philips Executives in the Netherlands.



### Review of financial statements; Audit Committee

The Supervisory Board reviews the annual financial statements as presented by the Board of Management and, upon approval, all individual members of the Supervisory Board (together with the members of the Board of Management) will sign these documents.

The Audit Committee, currently consisting of three members of the Supervisory Board, assists the Supervisory Board in fulfilling its oversight responsibilities for the integrity of the Company's financial statements, the financial reporting process, the system of internal business controls and risk management, the internal and external audit process, the internal and external auditor's qualifications, independence and performance, as well as the Company's process for monitoring compliance with laws and regulations and the General Business Principles. The Audit Committee reports its findings to the Supervisory Board.

It reviews the Company's annual and interim financial statements, including non-financial information, prior to publication and assesses the adequacy and appropriateness of internal control policies and internal audit programs and their findings. It reviews matters relating to accounting policies and compliance with accounting standards, compliance with statutory and legal requirements and regulations particularly in the financial domain. Important findings and identified risks are examined thoroughly in order to allow appropriate measures to be taken. With regard to internal audit, the Audit Committee reviews the internal audit charter, audit plan, audit scope and its coverage in relation to the scope of the external audit, as well as the staffing, independence and organizational structure of the internal audit function. With regard to the external audit, the Committee reviews the proposed audit scope, approach and fees (refer to page 37 of the separate booklet entitled 'Financial Statements and Analysis' for a summary of aggregate audit fees), the independence of the external auditors, their performance and their (re-)appointment, non-audit services provided by the external auditors in conformity with the Philips Policy on Auditor Independence, as well as any changes to this Policy. The Committee also considers the report of the external auditors with respect to the annual financial statements. It also gives advice about the Supervisory Board's statement to shareholders in the annual accounts. The Audit Committee periodically discusses the Company's policy on business controls, the General Business Principles including the deployment thereof, and the Company's major areas of risk, including the internal auditor's reporting thereon. The

Company's internal and external auditors attended all Committee meetings in 2002, and the Committee met separately on a quarterly basis with the President/Chief Executive Officer, the Chief Financial Officer, the Internal Auditor and the External Auditors.

### 2002 financial statements

The financial statements of Koninklijke Philips Electronics N.V. for 2002, as presented by the Board of Management, have been audited by KPMG Accountants N.V., independent auditors. Their report appears on page 127 of the separate booklet entitled 'Financial Statements and Analysis'. We have approved these financial statements.

We recommend to shareholders to adopt the 2002 financial statements as presented in the full Annual Report for the year 2002. We likewise recommend to shareholders to adopt the proposal of the Board of Management, approved by the Supervisory Board and the Meeting of Priority Shareholders, to make a distribution to shareholders of EUR 0.36 per common share from the other reserves.

February 7, 2003

*The Supervisory Board*



## Selected Financial Information

### Introduction

This Management Report and the separate booklet entitled 'Financial Statements and Analysis' together comprise the full Annual Report 2002 of Royal Philips Electronics. Selected Financial Information is derived from the Philips Group's full annual financial statements including notes as reported in the separate booklet entitled 'Financial Statements and Analysis'. That separate booklet also contains a comprehensive Operating and Financial Review and Prospects, additional financial information and further statutory and other information. For a full understanding of the results of the Group and the state of affairs, both booklets should be consulted.

The following Selected Financial Information should be read in conjunction with the Report on the performance of the Philips Group set out earlier in this Management Report.

### Auditors' report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the Netherlands, the consolidated balance sheets of Koninklijke Philips Electronics N.V. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2002 (not presented separately herein); and in our report dated February 7, 2003, we expressed an unqualified opinion on those consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated financial statements, appearing on pages 66 through 71, is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

Eindhoven, February 7, 2003

*KPMG Accountants N.V.*

### Accounting policies

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States ('US GAAP').

# Condensed consolidated statements of income of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

	2002	2001
Sales	31,820	32,339
Cost of sales	(21,906)	(23,240)
<b>Gross margin</b>	<b>9,914</b>	<b>9,099</b>
Selling expenses	(5,017)	(5,027)
General and administrative expenses	(1,404)	(1,249)
Research and development expenses	(3,043)	(3,312)
Write-off of acquired in-process R&D	(12)	(106)
Impairment of goodwill	(19)	–
Restructuring and impairment charges	(484)	(786)
	(9,979)	(10,480)
Other business income (expense)	485	(14)
<b>Income (loss) from operations</b>	<b>420</b>	<b>(1,395)</b>
Financial income and expenses:		
- interest	(384)	(391)
- impairment charges	(1,955)	(526)
- other	112	2
	(2,227)	(915)
<b>Income (loss) before taxes</b>	<b>(1,807)</b>	<b>(2,310)</b>
Income tax (expense) benefit	(27)	428
<b>Income (loss) after taxes</b>	<b>(1,834)</b>	<b>(1,882)</b>
Results relating to unconsolidated companies:		
- income (loss) excluding impairment charges and amortization of goodwill	(17)	(232)
- impairment charges	(1,305)	(119)
- amortization of goodwill	(24)	(257)
	(1,346)	(608)
<b>Group income (loss)</b>	<b>(3,180)</b>	<b>(2,490)</b>
Minority interests	(26)	15
<b>Net income (loss)</b>	<b>(3,206)</b>	<b>(2,475)</b>

Weighted average number of common shares outstanding  
(after deduction of treasury stock) during the year  
(in thousands)

1,274,950 1,278,077

## Basic earnings per common share in euros:

Net income (loss) (2.51) (1.94)

## Diluted earnings per common share in euros:\*

Net income (loss) (2.51) (1.94)

Dividend paid per common share in euros  
(related to prior financial year)

0.36 0.36

\* The dilution effects on EPS are only taken into consideration if this does not result in an improvement in income per share or in a reduction in loss per share, as is the case in 2002 and 2001.

# Condensed consolidated balance sheets of the Philips Group as of December 31

in millions of euros

	2002	2001
<b>Current assets</b>		
Cash and cash equivalents	1,858	890
Receivables	5,068	5,812
Inventories	3,522	4,290
Other current assets	<u>603</u>	<u>858</u>
Total current assets	11,051	11,850
<b>Non-current assets</b>		
Unconsolidated companies	6,089	7,552
Other non-current financial assets	1,306	3,481
Non-current receivables	219	306
Other non-current assets	2,553	2,774
Property, plant and equipment – net	6,137	7,718
Intangible assets excl. goodwill – net	1,742	1,964
Goodwill – net	<u>3,192</u>	<u>3,557</u>
Total non-current assets	<u>21,238</u>	<u>27,352</u>
<b>Total</b>	<b>32,289</b>	<b>39,202</b>
<b>Current liabilities</b>		
Accounts and notes payable	3,228	3,243
Accrued liabilities	3,314	3,966
Short-term provisions	1,276	1,443
Other current liabilities	691	813
Short-term debt	<u>617</u>	<u>1,271</u>
Total current liabilities	9,126	10,736
<b>Non-current liabilities</b>		
Long-term debt	6,492	6,595
Long-term provisions	1,970	2,297
Other non-current liabilities	<u>603</u>	<u>212</u>
Total non-current liabilities	9,065	9,104
<b>Group equity</b>		
Minority interests	179	202
Stockholders' equity	<u>13,919</u>	<u>19,160</u>
<b>Total</b>	<b>32,289</b>	<b>39,202</b>



# Condensed consolidated statements of cash flows of the Philips Group for the years ended December 31

in millions of euros

	2002	2001
<b>Cash flows from operating activities:</b>		
<b>Net income (loss)</b>	<b>(3,206)</b>	<b>(2,475)</b>
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,184	2,671
Impairment of equity investments	3,260	645
Net gain on sale of assets	(643)	(337)
Loss from unconsolidated companies (net of dividends received)	54	501
Minority interests (net of dividends paid)	26	(21)
Decrease in working capital	815	752
Decrease (increase) in non-current receivables/other assets	86	(888)
(Decrease) increase in provisions	(336)	313
Other items	(12)	87
<b>Net cash provided by operating activities</b>	<b>2,228</b>	<b>1,248</b>
<b>Cash flows from investing activities:</b>		
Purchase of intangible assets (software)	(149)	(234)
Capital expenditures on property, plant and equipment	(1,161)	(2,143)
Proceeds from disposals of property, plant and equipment	370	221
Cash from derivatives	422	–
Purchase of other non-current financial assets	(15)	(77)
Proceeds from other non-current financial assets	98	550
Purchase of businesses, net of cash acquired	(626)	(3,636)
Proceeds from sale of interests in businesses	813	755
<b>Net cash used for investing activities</b>	<b>(248)</b>	<b>(4,564)</b>
<b>Cash flows before financing activities</b>	<b>1,980</b>	<b>(3,316)</b>
<b>Cash flows from financing activities:</b>		
Decrease in short-term debt	(548)	(73)
Principal payments on long-term debt	(276)	(554)
Proceeds from issuance of long-term debt	405	4,580
Treasury stock transactions	(19)	(336)
Dividends paid	(459)	(458)
<b>Net cash (used for) provided by financing activities</b>	<b>(897)</b>	<b>3,159</b>
<b>Cash provided by (used for) continuing operations</b>	<b>1,083</b>	<b>(157)</b>
Effect of changes in exchange rates and consolidations on cash positions	(115)	(42)
<b>Cash and cash equivalents at beginning of year</b>	<b>890</b>	<b>1,089</b>
<b>Cash and cash equivalents at end of year</b>	<b>1,858</b>	<b>890</b>

# Condensed consolidated statements of changes in stockholders' equity of the Philips Group

in millions of euros

	common stock	capital in excess of par value	retained earnings	Accumulated other comprehensive income (loss)					treasury shares at cost	total stock- holders' equity
				currency translation differences	available for sale securities	minimum pension liability	cash flow hedges	total		
<b>Balance as of December 31, 2000</b>	<b>263</b>	<b>7</b>	<b>23,336</b>	<b>(868)</b>	<b>972</b>	<b>(13)</b>	<b>(29)</b>	<b>62</b>	<b>(961)</b>	<b>22,707</b>
Net income (loss)			(2,475)							(2,475)
Net current period change				102	(932)	(18)	(18)	(866)		(866)
Reclassifications into income					526	13	40	579		579
Total comprehensive income (loss), net of tax				102	(406)	(5)	22	(287)		(2,762)
Dividend paid			(458)							(458)
Purchase of treasury stock									(379)	(379)
Re-issuance of treasury stock									46	46
Stock options accrual		6								6
<b>Balance as of December 31, 2001</b>	<b>263</b>	<b>13</b>	<b>20,403</b>	<b>(766)</b>	<b>566</b>	<b>(18)</b>	<b>(7)</b>	<b>(225)</b>	<b>(1,294)</b>	<b>19,160</b>
Net income (loss)			(3,206)							(3,206)
Net current period change				(906)	(2,189)	(335)	(28)	(3,458)		(3,458)
Reclassifications into income				(40)	1,888		46	1,894		1,894
Total comprehensive income (loss), net of tax				(946)	(301)	(335)	18	(1,564)		(4,770)
Dividend paid			(459)							(459)
Purchase of treasury stock									(103)	(103)
Re-issuance of treasury stock									90	90
Stock options accrual		1								1
<b>Balance as of December 31, 2002</b>	<b>263</b>	<b>14</b>	<b>16,738</b>	<b>(1,712)</b>	<b>265</b>	<b>(353)</b>	<b>11</b>	<b>(1,789)</b>	<b>(1,307)</b>	<b>13,919</b>

# The Philips Group in the last nine years

all amounts in millions of euros unless otherwise stated

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

## General data

	2002	2001	2000	1999	US GAAP		1997	1996	Dutch GAAP	
					1998*	1998*			1995	1994
Sales	31,820	32,339	37,862	31,459	30,459	30,459	29,658	27,094	25,259	23,768
Percentage increase over previous year	(2)	(15)	20	3	3	3	9	7	6	2
Income (loss) from continuing operations <sup>1)</sup>	(3,206)	(2,475)	9,577	1,595	1,025	541	1,231	126	971	683
Discontinued operations <sup>2)</sup>	–	–	–	–	4,891	5,054	263	202	247	281
Cumulative effect of change in accounting principle	–	–	85	–	–	–	–	–	–	–
Net income (loss)	(3,206)	(2,475)	9,662	1,590	5,900	6,053	2,602	(268)	1,143	964
Turnover rate of net operating capital	2.43	2.15	3.12	3.20	2.95	2.91	2.84	2.70	2.88	2.95
Total employees at year-end (in thousands)	170	189	219	227	234	234	252	250	253	241
Salaries, wages and social costs paid	8,183	8,119	8,479	8,111	8,117	8,209	8,261	8,083	7,363	7,031

## Income

Income (loss) from operations	420	(1,395)	4,258	1,553	1,289	685	1,714	422	1,350	1,227
As a % of sales	1.3	(4.3)	11.2	4.9	4.2	2.2	5.8	1.6	5.3	5.2
As a % of net operating capital (RONA)	3.2	(9.3)	35.1	15.8	12.5	6.5	16.4	4.2	15.4	15.2
Income taxes	(27)	428	(563)	(208)	(162)	(41)	(276)	7	(74)	(135)
As a % of income before taxes	(1)	19	9	14	17	11	20	(40)	7	16
Income (loss) after taxes	(1,834)	(1,882)	5,688	1,238	816	332	1,119	25	964	696
As a % of sales	(5.8)	(5.8)	15.0	3.9	2.7	1.1	3.8	0.1	3.8	2.9
Income (loss) from continuing operations	(3,206)	(2,475)	9,577	1,595	1,025	541	1,231	126	971	683
As a % of stockholders' equity (ROE)	(19.2)	(11.9)	48.5	10.9	9.7	5.1	15.9	1.9	15.8	12.5
Per common share in euros	(2.51)	(1.94)	7.30	1.16	0.71	0.38	0.88	0.09	0.71	0.51
Net income (loss)	(3,206)	(2,475)	9,662	1,590	5,900	6,053	2,602	(268)	1,143	964
Per common share in euros	(2.51)	(1.94)	7.36	1.15	4.10	4.20	1.86	(0.20)	0.84	0.72
Dividend paid per common share in euros (related to prior financial year)	0.36	0.36	0.30	0.25	0.23	0.23	0.18	0.18	0.14	0.06

\* The Company adopted application of US GAAP as from January 1, 2002. The years from 1998 onwards have been restated accordingly. Previous years have not been restated. For the convenience of the reader the 1998 figures are presented on the basis of both US and Dutch GAAP.

<sup>1)</sup> Under Dutch GAAP, prior to 1999, certain material transactions, such as disposals of lines of activities, were accounted for as extraordinary items, whereas under US GAAP these would have been recorded in income (loss) from (continuing) operations.

<sup>2)</sup> Discontinued operations reflect the effect of the sale of PolyGram N.V. in 1998 in order to present the Philips Group accounts on a continuing basis.

### Definitions

Net operating capital:	intangible assets, property, plant and equipment, non-current receivables and current assets excl. cash and cash equivalents, securities and deferred tax positions, after deduction of provisions and other liabilities
RONA:	income from operations as a % of average net operating capital
ROE:	income from continuing operations as a % of average stockholders' equity
Net debt:	long-term and short-term debt net of cash and cash equivalents
Net debt : group equity ratio:	the % distribution of net debt over group equity plus net debt
Average number of outstanding shares:	weighted average number of outstanding common shares based on monthly positions during the reporting year

The financial statements have been prepared in euros. Amounts previously reported in Dutch guilders are reported in euros using the irrevocably fixed conversion rate which became effective on January 1, 1999 (EUR 1 = NLG 2.20371).

## Capital employed

		US GAAP					Dutch GAAP			
	2002	2001	2000	1999	1998*	1998*	1997	1996	1995	1994
Cash and cash equivalents	1,858	890	1,089	2,331	6,553	6,553	1,397	785	932	940
Receivables	5,671	6,670	6,806	6,453	5,442	5,442	5,464	5,369	4,890	4,567
Inventories	3,522	4,290	5,279	4,268	4,017	4,274	4,522	4,334	5,083	4,330
Current assets	11,051	11,850	13,174	13,052	16,012	16,269	11,383	10,488	10,905	9,837
Non-current financial assets	7,395	11,033	11,306	7,400	2,871	2,836	1,451	1,618	1,358	1,257
Net assets discontinued operations	–	–	–	–	–	–	1,482	1,198	1,013	901
Non-current receivables	2,772	3,080	2,713	2,326	1,920	1,920	1,858	1,662	1,413	1,397
Property, plant and equipment (book value)	6,137	7,718	9,041	7,332	6,597	6,574	6,935	6,719	6,094	5,599
Intangible assets (book value)	4,934	5,521	3,290	1,563	609	554	213	222	198	105
Non-current assets	21,238	27,352	26,350	18,621	11,997	11,884	11,939	11,419	10,076	9,259
Total assets	32,289	39,202	39,524	31,673	28,009	28,153	23,322	21,907	20,981	19,096
Property, plant and equipment:										
Capital expenditures for the year	1,161	2,143	3,170	1,662	1,634	1,634	1,627	2,185	2,127	1,535
Depreciation for the year	1,782	1,969	1,789	1,548	1,615	1,615	1,492	1,437	1,218	1,270
Capital expenditures : depreciation	0.7	1.1	1.8	1.1	1.0	1.0	1.1	1.5	1.7	1.2
Inventories as a % of sales	11.1	13.3	13.9	13.6	13.2	14.0	15.2	16.0	20.1	18.2
Outstanding trade receivables, in months' sales	1.3	1.5	1.5	1.4	1.3	1.3	1.3	1.3	1.5	1.5

## Financial structure

Other liabilities	7,836	8,234	8,764	8,262	6,751	6,779	6,328	5,768	5,643	5,373
Debt	7,109	7,866	4,027	3,314	3,587	3,587	4,030	5,855	4,756	3,875
Provisions	3,246	3,740	3,557	3,056	2,973	2,985	3,251	3,420	3,460	3,566
Total provisions and liabilities	18,191	19,840	16,348	14,632	13,311	13,351	13,609	15,043	13,859	12,814
Issued, paid-up capital	263	263	263	339	1,672	1,672	1,655	1,600	1,566	1,536
Surplus and reserves	13,656	18,897	22,444	16,369	12,784	12,888	7,499	4,985	5,060	4,410
Stockholders' equity	13,919	19,160	22,707	16,708	14,456	14,560	9,154	6,585	6,626	5,946
Minority interests	179	202	469	333	242	242	559	279	496	336
Group equity	14,098	19,362	23,176	17,041	14,698	14,802	9,713	6,864	7,122	6,282
Total equity and liabilities	32,289	39,202	39,524	31,673	28,009	28,153	23,322	21,907	20,981	19,096
Net debt : group equity ratio	27:73	26:74	11:89	5:95	**	**	21:79	42:58	35:65	32:68
Stockholders' equity per common share in euros	10.91	15.04	17.69	12.55	10.02	10.09	6.39	4.74	4.85	4.41
Market price per common share at year-end	16.70	33.38	39.02	33.75	14.30	14.30	13.80	7.94	6.58	5.83

\*\* Not meaningful: net cash in 1998 exceeded the debt level

Shareholder information

Detailed information for shareholders is available on our website [www.investor.philips.com](http://www.investor.philips.com).  
As well as financial reports and presentations, the site also provides information on related issues, such as governance, business ethics and sustainability.



Payment of distribution to shareholders

Shares of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics') will be listed ex-dividend as of March 28, 2003. In compliance with the listing requirements of the New York Stock Exchange and the stock market of Euronext Amsterdam, the record dates will be April 1, 2003 for holders of American shares of New York Registry, and March 27, 2003 for other Philips shares. The distribution in cash as proposed to the General Meeting of Shareholders will be payable as of April 7, 2003 to all shareholders. The distribution to holders of American shares will be made in USD at the USD/EUR rate fixed by the European Central Bank on April 2, 2003.

Important dates

Record date Annual General Meeting of Shareholders	March 20, 2003
Annual General Meeting of Shareholders	March 27, 2003
First quarterly report 2003	April 15, 2003
Second quarterly report 2003	July 15, 2003
Third quarterly report 2003	October 14, 2003
Publication of 2003 results	February 10, 2004*
Publication of the Annual Report 2003	February 10, 2004*
Annual General Meeting of Shareholders	March 25, 2004*
First quarterly report 2004	April 13, 2004*
Second quarterly report 2004	July 13, 2004*
Third quarterly report 2004	October 12, 2004*

\* These dates are subject to final confirmation.