



#### Home entertainment

Philips' digital home entertainment systems offer the ideal combination of convenience, excitement and design.



#### Personal healthcare

Our personal healthcare products are designed for people who want to take control of their own health.

#### '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 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.

#### Use of non-GAAP Information

In presenting and discussing the Philip Group's financial position, operating results and cash flows, management uses certain non-GAAP financial measures. These non-GAAP financial measures should not be viewed in isolation as alternatives to the equivalent GAAP measure and should be used in conjunction with the most directly comparable US GAAP measure(s). Unless otherwise indicated in this document, a discussion of the non-GAAP measures included in this document and a reconciliation of such measures to the most directly comparable US GAAP measure(s) is contained in the separate booklet entitled 'Financial Statements and Analysis', which together with this book comprises the full Annual Report for the year 2003 of Royal Philips Electronics.

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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 2003 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.

# Financial highlights

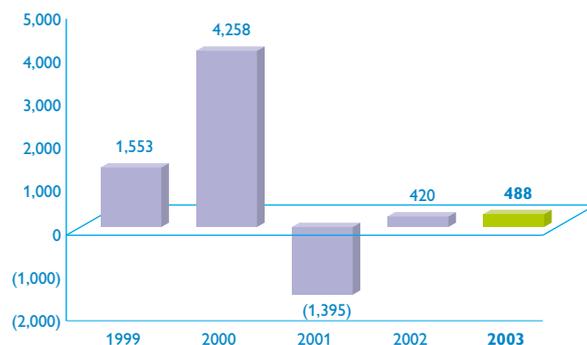
## Sales

in billions of euros and % growth



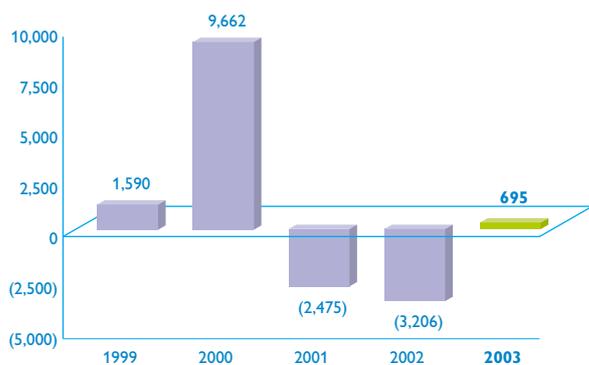
## Income (loss) from operations

in millions of euros



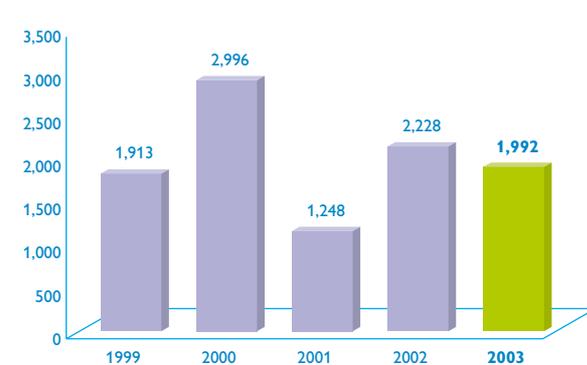
## Net income (loss)

in millions of euros



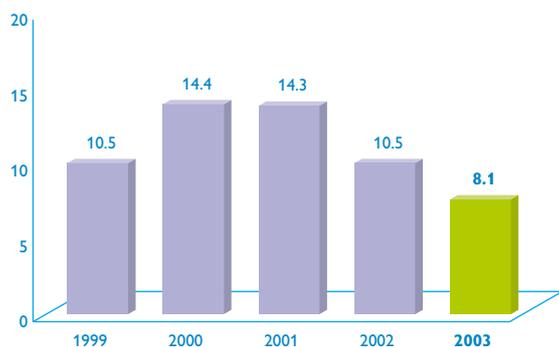
## Cash flows from operating activities

in millions of euros



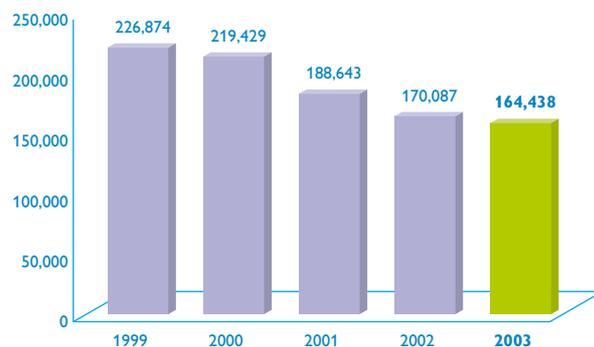
## Net operating capital

in billions of euros



## Employees

number at year-end







Dear shareholder,

Over the past year we have made considerable progress on our journey to create One Philips – a single, focused and clearly identifiable company geared to sustained value creation in the key areas of healthcare, lifestyle and technology. Strict financial discipline, focused execution of our management agenda and resolute pursuit of our strategy have guided us in this endeavor.

In 2003 our change programs and the asset management and cost control measures implemented over the previous two years delivered significant benefits. Sales, at EUR 29 billion, were impacted by the weak dollar, but comparable sales increased by 4%, with strong 10% year-on-year growth in the fourth quarter. Income from operations benefited from performance improvements at Medical Systems, Consumer Electronics (including Licenses) and Semiconductors, as well as significant cost savings, more than offsetting higher pension costs. Especially encouraging is the fact that in the fourth quarter all our five product divisions delivered healthy levels of profitability. Our unconsolidated companies, in particular TSMC and the LG.Philips LCD joint venture, also made a strong contribution. The LG.Philips Displays joint venture had a more difficult year. Group net income rose sharply to EUR 695 million.

Cash flow from operating activities came to EUR 2 billion, thanks to our improved operating performance combined with our undiminished focus on supply chain management and tight capital management.

# We have made considerable progress on our journey to create One Philips

It is gratifying to note that our stakeholders recognize the advances we are making. In the Euro-zone our share price gained almost 40% in 2003, while US dollar investors witnessed a rise of over 60%. And we are particularly proud to have been selected as the No. 1 company in our main industry category in the Dow Jones Sustainability Index.

Though we are pleased with the progress we made in a year that was characterized by the SARS outbreak in Asia, the war in Iraq, an increasingly weak US dollar, the fragile upturn in Europe and the recovery in the US, we are still far from satisfied with the absolute level of our performance. Our positive momentum does, however, give us reason for cautious optimism.

## Delivering on commitments

A year ago we committed to delivering on the following management agenda:

- achieve cost savings of EUR 1 billion
- restore Semiconductors to profitability by the end of the year
- 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.

Let me now go through each of these commitments and show you how we performed.

## Achieve cost savings of EUR 1 billion

In 2003 we again made excellent progress with our two-year program to cut costs, exceeding our ambitious target of EUR 1 billion savings by the end of the year. During the past year alone we achieved additional consolidated savings of EUR 486 million. The savings were realized through a reduction in overhead costs, post-merger integration savings at Medical Systems, and other initiatives designed to lower our cost base, e.g. in the fields of non-product-related purchasing and R&D. However, this was much more than just an exercise in cost-cutting: it was an essential part of our program to create a simpler, more responsive organization, with more to come from the roll-out of shared services in Finance and HRM.

## Restore Semiconductors to profitability

Semiconductors delivered on all points of their improvement plan, resulting in an 11% operating margin in the fourth quarter. Capacity was rationalized, primarily through the closure of our older production facilities in San Antonio and Albuquerque. R&D efforts have been focused on connected consumer applications, structures simplified and throughput times reduced. Most importantly, sequential revenue in the fourth quarter increased 22% in USD terms, signaling good market acceptance of the system solutions based on our Nexperia platform. This gives us confidence for the future.

## Consumer Electronics in the USA

I am very pleased with the progress Consumer Electronics made in 2003. Our US operations managed to reach break-even in the fourth quarter, while taking additional measures to further lower the cost base for 2004. On a global level Consumer Electronics has in recent years continually lowered its risk exposure and reduced costs. As a result, the division has emerged a good deal leaner and fitter, and we expect to be able to achieve further annual savings of EUR 400 million within two years by executing our business renewal program. On the revenue side we are focusing on winning market share in key categories, with exciting, leading-edge products such as our Flat TV and DVD+RW ranges.

## Achieve 14% EBITA for Medical Systems in 2004

Medical Systems progressed according to plan, realizing synergy benefits of almost EUR 350 million. Income from operations increased by 39% to EUR 431 million, on track for our EBITA objective of 14% in 2004. Having completed the imaging portfolio with the recent acquisitions, and inspired by a long-term vision of removing traditional healthcare boundaries, the focus over the coming years will shift to expanding customer services and healthcare IT while developing new initiatives in the areas of personal healthcare and molecular medicine. An important step in 2003 was the alliance with Epic Systems Corporation to provide enterprise software, medical imaging and monitoring

IT solutions that integrate patient information enterprise-wide.

In November, Medical Systems introduced its vision of 'healthcare without boundaries', exemplified by the Ambient Experience Pavilion that was unveiled at the 2003 Annual Meeting of the Radiological Society of North America. This concept recognizes that clinical efficacy goes much further than excellent processes, systems and infrastructure alone, and aims to create an optimum, patient-centric environment for diagnosis, treatment and all supporting services.

In 2003 Medical Systems' strong performance received recognition in the form of four Frost and Sullivan Awards, including that of *Medical Imaging Company of the Year*.

## Making Philips a truly market-driven company

Our objective of transforming Philips into a truly market-driven company involves an ongoing effort to build strong customer intimacy across the entire organization, develop a superior brand strategy and foster best-in-class marketing competencies to drive profitable growth. We made good progress on this front in 2003, strengthening our key account management, identifying the core target group for our marketing message, and developing a clear positioning for our brand, which will be rolled out in 2004. Specific branding plans have been formulated for the US and China to strengthen awareness and preference for

# It is now time to extend our leading market positions in the interlocking areas of healthcare, lifestyle and technology

Philips. We also consolidated to one advertising agency to enhance consistent delivery. Market-led innovation and new business development will remain high on the agenda as we go forward.

## Improved presence across regions

In recent years we have been working hard to broaden our regional base, for instance by investing heavily in our presence in the USA through our expansion in healthcare. As a result, the USA now accounts for almost a third of our sales and over 28,000 of our employees. Some of the most significant opportunities for growth for Philips are in the Asia Pacific region. Philips' ties with China, for example, go back a long way: we opened our first offices there in the 1920s and have since grown to become the largest foreign multinational in China in 2002. Over the next three to four years we aim to significantly grow our business in Asia Pacific, which in 2003 already stood at just over EUR 7 billion in sales – or 25% of our total sales. We also employ over 47,000 people in Asia – close to 29% of our global workforce. Underscoring our ambitions in this part of the world, the company's top management made collective working visits to India and China in the course of the year, the aim being to gather as much information as possible, e.g. from decision-makers and our partners and customers, to enable us to take the most effective approach possible to this region. We are also determined to strengthen our highest management echelons with the infusion of top Asian talent.

## Strengthened leadership and improved corporate governance

In our organization we strive for the highest levels of integrity, transparency and accountability. It is our firm belief that this results from the combination of having the right people, sound business principles and world-class business processes.

During 2003 we were again able to improve in all three dimensions. We have broadened and strengthened our leadership, for example with the appointment of seven new members to our Group Management Committee, with a good diversity of age, gender, nationality and experience, both inside and outside the company.

We have reviewed and further tightened our corporate governance, including our General Business Principles, and we are fully compliant with the requirements of the Sarbanes-Oxley Act. We are also in the process of adopting the recommendations of the Dutch Code on Corporate Governance.

We have further improved our transparency to our stakeholders by enhancing the information in our quarterly financial reports and endorsing the work of the Global Reporting Initiative for our sustainability reporting.

Our business excellence program BEST drives continuous process improvement, for instance through our unique set of process survey tools and the exchange of best practices across all our divisions.

## Leadership in healthcare, lifestyle and technology

Having come through a period of difficult economic conditions, where we focused heavily on cost control and operational improvement, we have emerged a stronger, more competitive company. Driven on by our mission to improve the quality of people's lives through the timely introduction of meaningful technological innovations, we must now work towards extending our leading market positions in the three key and interlocking areas of healthcare, lifestyle and enabling technology – markets in which Philips can set the pace.

This calls for a broader view of how the integral parts of Philips can interact to generate greater synergy. Take healthcare – an important growth market, and one that is particularly interesting for us. The rising cost of healthcare, combined with the increasing empowerment of patients-as-consumers, is going to lead to an explosion of demand for personalized diagnostic and (remote) monitoring devices and services. With our mix of consumer experience and medical technology, we are well placed to deliver these kinds of solutions.

## Our Group strategy

Reflecting the opportunities and ambitions outlined before, we have set ourselves clear goals for the coming years. From a financial perspective we will consistently earn returns in excess of our cost of capital; self-evident as it may seem, for Philips this has been more the

exception than the rule, and this must change. Also, we will improve the profitability of our portfolio to 7 to 10% operating margin within the next two to three years. We will do this by re-allocating capital towards opportunities that offer higher rates of return and by improving productivity through the pursuit of operational excellence and ongoing business transformation. We will continue to leverage our brand and core competencies in healthcare, lifestyle and technology while building partnerships with key customers to achieve growth. And in order to sustain this growth in the longer term, we will continue to invest in our world-class R&D infrastructure and further capitalize upon our strong position in the field of intellectual property.

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

With these objectives in mind, we have committed ourselves to the following management agenda for the year 2004:

- achieve 14% EBITA at Medical Systems
- implement Consumer Electronics' renewal program to achieve stable 4 - 4.5% operating margin by the end of 2005
- accelerate profitable growth through the sustained transformation of Philips into a market-driven organization

- increase the number of product leadership positions and the innovation rate across the Group
- continue to focus on indirect cost to achieve additional savings of EUR 250 million.

On behalf of my colleagues on the Board of Management, I would like to thank all our employees, who have again worked hard to ensure the company's success. A special word of thanks goes to our colleague Arthur van der Poel, who stepped down from the Board of Management in April, for his contributions to the Company. I also wish to thank you, our shareholders, for your continued support over the last twelve months.

I can assure you that we are determined to carry forward the spirit of teamwork and enterprise shown during the past year as we pursue our goal of market leadership and sustained, profitable growth.

A handwritten signature in black ink, appearing to read 'G. Kleisterlee', written over two horizontal lines.

Gerard Kleisterlee,  
*President*

# Philips 2004

For over a century Philips has been providing people with meaningful technology that makes their lives easier, simpler and better. The company has pioneered major breakthroughs, for instance in lighting, television, optical technology, medical imaging and integrated circuits. We will continue to use our understanding of how people experience technology to deliver innovations that improve their lives.

We have embarked on a journey to create One Philips – a single, focused and clearly identifiable company geared to delivering sustained profitability in the key areas of healthcare, lifestyle and technology. In order to ensure that we remain on track to achieve this strategic objective, we continually ask ourselves the following challenging questions:

- Do we know what our customers really want from us, and are we giving it to them?
- Are we creating technologies, products and services that will propel us towards leading market positions?
- Are we cost-effective while remaining an attractive and challenging employer?
- How can we further optimize our portfolio of businesses?
- Are we creating value while maintaining a strong financial position?

The answers to these questions provide us with the strategic framework on which to build for a future of sustained and profitable growth.

## Our mission

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

## Our vision

In a world where technology increasingly touches every aspect of our daily lives, we will be a leading solutions provider in the areas of healthcare, lifestyle and enabling technology, aspiring to become the most admired company in our industry as seen by our stakeholders.

## Our strategy

We will:

- increase profitability through re-allocation of capital towards opportunities offering higher returns
- leverage the Philips brand and our core competencies in healthcare, lifestyle and technology to grow in selected categories and geographies
- build partnerships with key customers, both in the business-to-business and business-to-consumer areas
- continue to invest in maintaining world-class R&D and leverage our strong intellectual property portfolio
- strengthen our leadership competencies
- drive productivity through business transformation and operational excellence

## Our values

Delight customers

Deliver on commitments

Develop people

Depend on each other



## Lighting

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



## Consumer Electronics

- Display
- Video
- Audio
- Consumer Communications
- Peripherals & Accessories
- Licenses



## Domestic Appliances and Personal Care

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



## Semiconductors

- Consumer Systems
- Communications
- MultiMarket Semiconductors
- Foundries
- Assembly & Test
- Mobile Display Systems



## Medical Systems

- X-ray
- Computed Tomography
- Magnetic Resonance
- Ultrasound
- Nuclear Medicine
- Medical IT
- Cardiac & Monitoring Systems
- Dictation & Speech Recognition Systems
- Personal Healthcare
- Customer Financing
- Document Management Services
- Asset Management Services



## Miscellaneous

- Technology & Design
- Corporate Investments
- Shared Services
- Navigation Technology
- Optical Storage

# Governance

## Corporate governance

For many years now Philips has pursued a consistent policy to enhance and improve its corporate governance – including its disclosure practices – in line with US, Netherlands and international codes of best practices. In its transparent two-tier corporate structure, the executive management is entrusted to the Board of Management under the supervision of the independent Supervisory Board. Both the Supervisory Board and the Board of Management are accountable to the General Meeting of Shareholders for the performance of their functions. All outstanding shares carry voting rights. Continuously striving to improve relations with its shareholders, the Company aims for a fair disclosure policy and follows an active investor relations approach.

Comprehensive internal procedures, compliance with which is supervised by the Supervisory Board and its Audit Committee, are in place for the preparation and publication of financial results and ad-hoc financial information. The annual financial statements, observing Dutch law and applying US GAAP, are presented for discussion and adoption to the shareholders meeting. A separate Form 20-F, incorporating the main part of the annual report, is filed with the US Securities and Exchange Commission. Apart from the certification by the CEO and CFO under US law, each individual member of the Supervisory Board and the Board of Management signs off the annual financial statements under Dutch law.

The Company has disclosed and maintains a policy of strict separation between the auditing and consulting functions of its external auditor, in line with US rules and regulations. The external auditor, who is assessed by the Supervisory Board and its Audit Committee, is appointed by the General Meeting of Shareholders. For several years, the Company has provided extensive details on the remuneration of individual members of the Board of Management. Against the background of the continuous endeavors to improve the Company's corporate governance, it requested – and received – in 2003 shareholders' approval for its Long-Term Incentive Plan, and it will submit the remuneration policy for members of the Board of Management to the 2004 shareholders meeting for approval. A new Dutch code on corporate governance was

published on December 9, 2003. Philips addresses the way it intends to further implement its overall corporate governance structure in the separate booklet entitled 'Financial Statements and Analysis'.

## Philips General 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 should be based. 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. 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.

At the end of 2003 an updated version of the General Business Principles was introduced.



In order to encourage reporting of violations, guaranteed-anonymity hotlines have been introduced in many countries. As of year-end 2003, such hotlines were in place in the Philips organizations in North America, Latin America and many countries of Asia Pacific and Europe.

With a view to ensuring maximum transparency for shareholders and other interested parties, a section of our Internet site ([www.philips.com/gbp](http://www.philips.com/gbp)) is devoted to the General Business Principles and specific issues of business ethics, such as political payments, military and defense contracts, and child labor.

To ensure full compliance with the highest standards of transparency and accountability by all employees performing important financial functions, in 2003 Philips formally adopted an extended Financial Code of Ethics that contains, 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 have to confirm adherence to this financial code.

Philips sources a large volume of products and services externally. In 2003 a Purchasing Code of Ethics was introduced, building upon best practice within Philips and in purchasing across the globe, to ensure that the Company's purchasing community and supply base adhere to the highest standards of ethical business conduct.

In 2003 a self-assessment questionnaire was developed to help management complete the General Business Principles section of the annual Statement on Business Controls. In a letter accompanying this questionnaire, the President of the Company reiterated the paramount importance of compliance with the General Business Principles in all actions and at all levels of the organization.

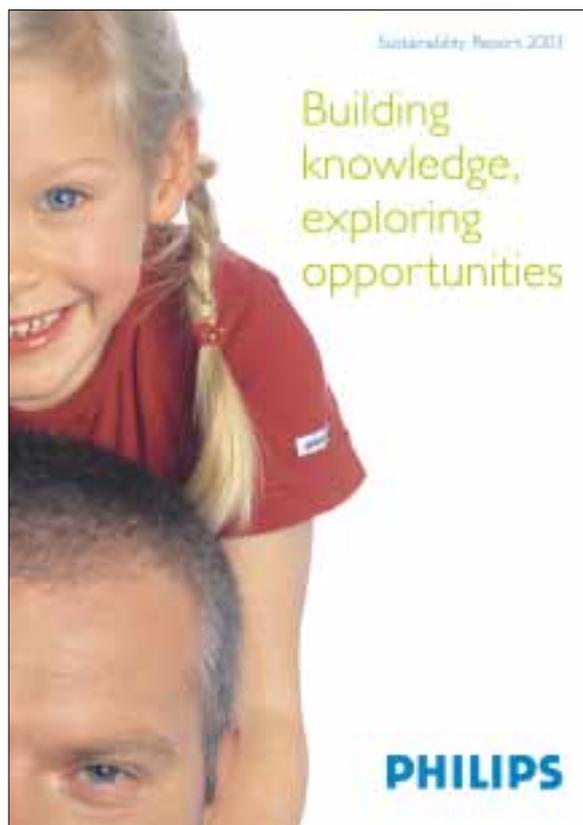
### Sustainability

We see sustainability as part of our overall corporate responsibility – economic, environmental and social – towards our employees, our customers and the communities in which we operate. The journey towards sustainability requires the kind of breakthrough thinking

that results in true innovation. It also calls for partnerships and cooperation as well as open, honest dialogue with stakeholders inside and outside the Company.

In 2003 we expanded the governance structure on sustainability, through the extension of our Sustainability Board with divisional management representatives. Transforming the existing environmental network at corporate, divisional and regional level into a team of Sustainability Support Managers was another part of this process. We also continued to intensify the dialogue with our stakeholders.

Full details of our efforts in the area of sustainability are presented in the separately published 'Philips Sustainability Report 2003', which will be available before the Annual General Meeting of Shareholders 2004.





## Home Depot

The long-term exclusive partnership between Home Depot and Philips Lighting in the USA continues to grow as new products and new marketing ideas are introduced to the giant retailer's in-store displays. Philips Lighting and Home Depot remain the leaders in the 'home center' category, the fastest-growing segment in the US lighting market.

# Capturing



## Isle of MTV

Following hot on the heels of the previous year's highly successful Station X Dance event in Berlin, Philips and MTV teamed up once again in 2003 for Isle of MTV – a summer-long program of youth dance events in eleven cities across Europe. The sponsorship program comprised integrated on-air and online promos running across the MTV Europe network, in-store promotions, joint PR activities and on-the-ground marketing activities, strengthening Philips' ties with the key youth market.





### Mirror TV

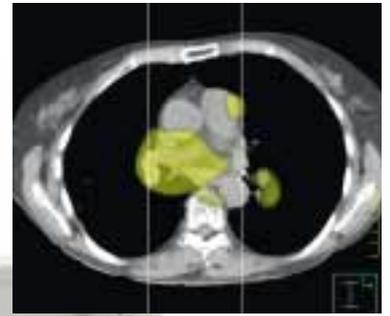
In 2003, Philips introduced the Mirror TV, a versatile 17-, 23- or 30-inch LCD display integrated into a mirror. The Mirror TV uses a unique polarized mirror technology, which transfers close to 100% of the light through the reflective surface. It represents a first step towards Philips' vision of ambient intelligence and is the first product resulting from Philips' HomeLab, the research facility where scientists study people's needs and motivations to use new technology.

# Technolo



### Dental delight

The Sonicare Elite, which arrived in stores in 2003, represents the new standard in oral hygiene. Blending next-generation sonic technology and the latest in design, the Sonicare Elite creates a powerful cleaning action that delivers superior plaque removal, reverses gingivitis and naturally whitens teeth. The Sonicare Elite's patented sonic technology creates a high-speed bristle motion to drive water and toothpaste into difficult-to-clean areas of the mouth. In addition, its bristle tips move three times faster than those of all other leading power toothbrushes. The result – cleaner teeth, healthier gums and fresh breath.



### Molecular imaging

Molecular imaging with the Gemini PET/CT system shows biochemical changes as well as the anatomical structures. In this combined PET/CT display, molecular imaging detects rapidly dividing cancer cells, shown in yellow. In close cooperation with innovative start-up companies we are pioneering breakthrough diagnoses and therapies using molecular imaging agents.

# gy for people



### A bridge to the future

Three of Glasgow's 120 m-long bridges over the River Clyde, the George V, the Glasgow and the Victoria, have been dramatically and beautifully floodlit using Philips LEDline 1.2 m linear floodlights. Each floodlight contains four modules of 12 high-brightness Luxeon Star 1W LEDs from Lumileds, the joint venture between Agilent Technologies and Philips Lighting.



### Connected Planet

In this age of progressive convergence we are seeing our consumer electronics and semiconductor solutions coming together to form the heart of the Connected Planet, a world where people can access entertainment, information and services anywhere, anytime and any way they want to. Without wires or any other form of restriction.

# New ideas, new



### Dynamic light

Shoebaloo, the exclusive shoe shop in Amsterdam, has had a complete refit, in which lighting from Philips features prominently. The light given off from the walls, ceiling and floor changes according to the time of day, creating an appealing, dynamic lighting ambience. Eight Scenio 100 architectural lighting controls form the heart of this installation.



### Putting the patient first

At the 2003 Annual Meeting of the Radiological Society of North America, we unveiled our Ambient Experience Pavilion, which showcases Philips' drive toward 'experience design', an innovative, human-focused approach that is used here to improve the experience of patients and clinicians who work with our medical equipment. The Pavilion presented at the RSNA is a circular space, built around the scan room of Philips' new Intera Achieva MR system. The ambience of the scan room, which is created by the projected wall images, ceiling visuals and room audio, can be instantaneously personalized by swiping a credit-card-sized 'mood token' before entering the room. Each token is linked to a database of content (images, sounds, etc). The presence of the tag inside the examination room is immediately detected by the entertainment system, which then activates the related content. The room fills with images and sounds, wrapping the user in an experience that he or she has chosen and putting him or her at ease.

# experiences



# Lighting

Philips Lighting strives to improve people's lives with effective and appealing lighting solutions based on a thorough understanding of people's needs, desires and aspirations.

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.

End-user-driven innovation, marketing excellence, delivery reliability and people are the key drivers for 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.

We want to be recognized by all our stakeholders as setting the pace in the lighting industry, as the best partner to do business with, and as a responsible corporate citizen contributing to the sustainability of society at large.



## Sweet dreams with 2-in-1 nightlight

Switch on, and you have a nightlight. Ideal to comfort a child waking at night, but also if you want to get up early without disturbing the family. Switch off and then on again, and you get beautiful soft white light. Ideal for reading a night-time story or playing a game with your child. As a nightlight, with dual LED technology, our new 2-in-1 bulb gives just the right amount of light to see by, saving 98% of the energy consumed by a 40 W incandescent lamp. And as soft white light, it matches the same 40 W incandescent lamp, but saves 75% of the energy.

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 43,800 people.

## Continued advances

Despite tough market conditions, Philips Lighting outpaced the competition in 2003, improving its processes with record delivery reliability and achieving success with innovative products like the UHP lamp for multimedia projectors and new products for shop lighting and automotive lighting.

## Personal experiences

In many areas of life we are seeing a trend towards personalization. And lighting is no exception. People want to be able to do a great deal more than operate a simple on/off switch. They want to be able to set their own stamp on their lighting – its design, its intensity, its color, its effects. They want the control and flexibility to shape the lighting experience. We are committed to

driving this process forward, in order to give our customers satisfying and inspiring lighting experiences.

This trend towards personalization is supported by solid-state lighting technology, which provides dynamics in lighting level and color, in addition to compactness, long life and increasing efficiency. Lumileds, Philips Lighting's joint venture with Agilent Technologies, is the global market leader in the area of high-power LEDs (light-emitting diodes) with its Luxeon product family in the colors red, green, blue and white. On the basis of these products, Philips has successfully introduced the LEDline for colored wall washing and the LED String for signage and decoration, expanding our presence in this rapidly emerging market.

## Sparkling light to enrapture shoppers

In the highly competitive world of retailing, the shopping experience is becoming increasingly important, and lighting is a key element in creating an environment and



#### XenEco

Our XenEco automotive headlamp sets new standards in the use of environmentally friendly materials, while offering the familiar Xenon benefits of twice as much light on the road and the daylight color of the light, helping to shorten driver reaction time and combat driver fatigue.

ambience that will capture and enrapture shoppers. In our lighting concepts, our focus is on the person actually *experiencing* our lighting solutions – the consumer. We also believe this is the best way we can support our customers in their business.

Product launches in 2003 included our new CDM-R111 lamp, the latest in our MASTER Colour CDM range, which provides dramatic highlighting effects in product displays and windows. Even against the high ambient lighting levels encountered in shop interiors, its sparkling and bright light helps to create an appealing ambience and enhances the shopping experience.

Also encouraging shoppers to linger, our new MASTER PL-H compact fluorescent lamp represents a genuine breakthrough. It helps customers to feel truly at ease as it offers maximum visual comfort thanks to

its flicker-free operation, while its excellent color rendering shows colors in their rich, natural hues.

#### Customer partnerships

Philips Lighting continues to focus on long-term partnerships with large customers.

These partnerships involve jointly bringing new products to the market and applying new marketing ideas in order to delight our customers' customers, resulting in higher sales and margins for both companies.

We find such partnerships right across our businesses.

#### 'Greener' driving with XenEco

Car drivers and their passengers are demanding ever-higher levels of safety and comfort on the road. In our Automotive business, fast growth is driven by innovations, especially in car headlights. Thanks to their superior performance and energy efficiency,



#### Cool clear water

Water-purification installations based on our UV light solutions were opened in Moscow and Beijing in 2003, to provide the people of these cities with improved drinking water.



### Shining a new light

With its UHP (Ultra High Performance) lighting system at the heart of digital projection-based devices such as micro-display projection TV and home projectors, Philips Lighting is shining a new light on the digital visual revolution.

Xenon HID bulbs have become accepted as the premium headlamp, increasing road safety and driver comfort more than any other light source.

At the same time, consumers and car makers around the world are becoming increasingly environmentally conscious. In response to this trend we have introduced to car makers our XenEco – setting new standards in the use of environmentally friendly materials, while offering the familiar Xenon benefits of twice as much light on the road and the daylight color of the light, helping to shorten driver reaction time and combat driver fatigue.

### Sustainable solutions

Being the market leader also means leading the way in corporate social responsibility. People's health and quality of life depend very much on the quality of the water they drink. We are addressing this issue by offering a range of environmentally sound solutions based on UV light to produce purer, clearer water in a safe and economical manner. Such installations were opened in Moscow and Beijing in 2003. Philips solutions

are also good for water-disinfection applications (removing bacteria), as UV light disinfects without the addition of chemicals that can produce harmful by-products and add an unpleasant taste to the water.

### Stronger together

A revolution is currently under way in home entertainment. With the rapid penetration of digital media, the consumer's expectations regarding the entire visual experience are much higher. In order to meet these growing expectations, Philips is increasingly seeking solutions across divisional boundaries. A good example in this respect is the Philips CINEOS Digital Projection TV. It is based on a combination of our Ultra High Performance lighting system and the reflective Micro Display, which utilizes Liquid Crystal on Silicon technology, itself the product of extensive group-wide collaboration.

# Consumer Electronics

Philips Consumer Electronics is gearing up for the future by implementing its Connected Planet vision – a vision centered around the powerful experiences we can offer consumers. Bringing people together by enabling them to access entertainment, information and services, at home, at work and on the move.

Our aim is to become the consumer's brand of choice in our targeted markets. To that end we are further intensifying our focus on translating our world-leading technologies into compelling solutions that reflect consumers' wishes, lifestyles and aspirations. By building on our technological competences we are able to deliver a rich brand experience. This recognizes that consumers are not interested simply in new technologies, products and functions, but much more in the new or enhanced experiences that these can bring to their everyday lives.

In the pursuit of our vision to be a premium brand excelling in 'consumer experience', Philips Consumer Electronics at the same time wants to be a financially predictable organization with a balanced spread in terms of products and regional presence.



## Jukebox

For consumers who want to take their entire music collections with them, the latest HDD100 and HDD60 micro audio jukeboxes allow them to enjoy a universe of music while on the move. These products provide easy, instant access to thousands of tracks, in an ultra-compact format that is not much longer than a credit card.

Philips Consumer Electronics is a global leader in connected displays, home entertainment hubs and networks, and mobile infotainment. The product range includes: widescreen and Flat TVs; monitors; optical disc products including DVD recorders and Super Audio CD; set-top boxes and web-enabled products; audio products such as portable audio players and mini and micro audio systems; PC peripherals such as DVD+RW data drives; and personal communication products including cellular phones and DECT phones. Philips Consumer Electronics has some 18,500 employees worldwide.

## Market successes

In 2003 we maintained our prominence in Western and Central Europe, achieving strong market share gains in the fast-growing Flat TV market, and making inroads in developing and emerging markets. In North America we established credibility with leading retailers and expanded our placements significantly. In Asia, we regained growth momentum in monitors, mobile phones and TV; in China we became the leading brand of monitors. In Latin America we implemented a derisked business model and reconfirmed our No. 1 position in Brazil for the 14th consecutive year. In the course of 2003, Philips Consumer Electronics received further prestigious

recognition for its acclaimed PixelPlus television technology, with two of its latest Flat TV models being named *European LCD TV of the Year 2003-2004* and *European Plasma TV of the Year 2003-2004* respectively by the European Imaging and Sound Association (EISA).

Nineteen Philips products, including the 44-inch Liquid Crystal on Silicon (LCoS) Television, the psal128 MP3 player, the iPronto TSi6400 universal remote control and the multi-changer SACD/DVD Home Entertainment System MX5900SA, were recognized as *2003 Best of Innovations* at the Consumer Electronics Show in Las Vegas.

## New business model

The increasing velocity of the innovation-to-commoditization cycle is challenging the entire consumer electronics industry. Fundamental change to the business model is needed if the industry is to move forward into a new growth era. We are breaking down the current organizational structure from one focused on product development and manufacturing to a more flexible model that emphasizes sales, marketing and a spirit of cooperative competition – allowing for open standards and shared development of new technologies. In this regard, we are also



#### Partnering for the new connected age

At the IFA consumer electronics fair in Berlin in August 2003 Philips unveiled its Connected Planet, a strategic vision of anytime anywhere access to the rich content and services promised by today's broadband, wireless and digital media technologies. A key element of the strategy involves partnerships with the world's leading telecommunications providers. Commenting on the importance of such alliances, Gerard Kleisterlee noted: "We work with telcos and content providers, packaging their services and entertainment with our equipment to give us a whole new marketplace in the world of 'PC-less broadband' and a different revenue model based on long-term partnerships. So we're not selling boxes any longer: we're service platform providers. That's a whole new category that didn't exist before."

expanding our alliances and partnerships to enter new markets based on the changing lifestyle needs of consumers.

#### The road ahead

As we move towards a more converged world, we are repositioning Consumer Electronics for future growth. Considerable advances have already been achieved in recent years as we migrated from analog to digital, from manufacturing to marketing, and from a broad to a more focused product portfolio. We will continue to compete on the basis of marketing-driven differentiation, lifecycle management, better business model designs, innovation, operational excellence, scale (organic or through alliances) and a more competitive operating cost base. With regard to the latter, we are accelerating our programs to make our organization less complex, more market-oriented, lean, agile, fast and entrepreneurial, also unlocking substantial annual savings by year-end 2005.

#### Connected Planet: the shape of things to come

Imagine a new, totally connected world in which we can access entertainment, information and services – anywhere, anytime and any way we want to. Without wires or restrictions. This is not a vague, futuristic concept: it is already available today in connectivity-oriented products

such as our Streamium range, which combines the storage and downloading capabilities of the PC with the excellent content 'rendering' – in terms of both sound and image reproduction – of our audio and display products.

These new products enable consumers to enjoy streaming content on different platforms – TV and PC, but also using exciting new concepts like the iPronto digital home 'dashboard' and the DesXcape multifunctional smart display device. This puts consumers in control, giving them maximum freedom of choice in terms of how, when and where they enjoy their digital content.

#### Broadband for the home

We are working with leading telecom operators such as Telefonica, KPN, British Telecom, Belgacom, Telecom Italia, France Telecom and Deutsche Telekom to promote the availability of the broadband services that are needed to develop the market for our connectivity products. Ahead of the Christmas season 2003, we achieved an industry first by launching bundled broadband products/services in cooperation with these telecom operators. This market is still in the early stages, but we intend to be the leading player, and to 'claim the domain' in seamlessly connected home entertainment.



#### Key Ring

In 2003 Philips introduced the innovative Key Ring range that allows consumers to 'wear' their MP3 audio, digital images and information. These players provide a highly portable platform for listening while on the move, with quick and easy PC uploading and simultaneous recharging thanks to USB connectivity. The Camera Key Ring even allows consumers to create their own instant memories, yet is small enough to be added to a key ring for easy carrying and wearing.



### Cooperating on wireless solutions

Together with Accton Technology Corporation of Taiwan, Philips formed Arcadyan Technology Corporation in 2003. This joint venture combines wireless infrastructure expertise with advanced capability in the integration of audio/video technology. With an emphasis on optimizing audio and video quality, Arcadyan's objective is to address the market's increasing demands for easy-to-use and cost-effective wireless solutions based on state-of-the-art technology in Wi-Fi (802.11), Bluetooth and other industry standards.

### Consumer experience – *Things to do your thing*

In order to ensure the effective delivery of 'consumer experiences', we have organized them into three domains – Home Entertainment, Productivity and Personal Expression. Through the Personal Expression experience we are targeting young, mobile consumers with a natural affinity with today's Internet-centric technologies. These consumers want the freedom to enjoy their favorite digital content and to share it with friends, any place, any time.

Our exciting new *Things to do your thing* product concept includes the Key Ring range that even allows consumers to 'wear' their MP3 audio, digital images and information, the latest HDD100 and HDD60 micro audio jukeboxes and the award-winning range of personal products that has arisen out of the Nike-Philips alliance.

In line with the *Things to do your thing* concept Philips teamed up with MTV Europe for a major summer-long program of youth dance events in major cities throughout Europe. The sponsorship program comprised integrated on-air and online promos made by MTV Europe running across the MTV Europe network, in-store promotions, joint PR activities and on-the-ground marketing activities.



### Express yourself

Products like the innovative Philips 530 mobile phone make sharing special moments more fun than ever, with a unique embedded photo library that enables consumers to personalize both their messages and the phone itself. Its other top-of-the-line features include the BeDJ audio recording and editing facilities, which let users enjoy a total music experience by creating, storing and sharing distinctive music mixes from a combination of downloaded sources, as well as tracks and sounds stored in the phone.

# Domestic Appliances and Personal Care

Philips Domestic Appliances and Personal Care (DAP) delivers a wide range of products that improve our quality of life – products that we use on a daily basis.

DAP strives to win over consumers by offering them exciting propositions that meet their needs in the area of home management and personal wellness. In this way DAP aims to achieve and consolidate leadership in its target markets through its power brands (Philishave and Sonicare worldwide, Norelco in the USA).

At the same time, the division is constantly pursuing breakthrough concepts to accelerate growth (and change the dynamics in mature markets), and further improving its operational performance, e.g. through asset management and diversity reduction.



## Smart appliance, smart look

Equipped with an intelligent water-level sensor that provides a constant high steam output, the Intellicare 8000 is the first fully electronically controlled steam ironing system on the market. With an easy-to-use programmable interface and sophisticated LCD screen, as well as a host of fabric settings, this appliance allows you to care for your garments better and faster.

Philips Domestic Appliances and Personal Care is responsible for a wide range of products that help consumers to prepare food and beverages, take care of their home and garments, and enhance their appearance and sense of well-being. The division comprises four business units – Shaving & Beauty, Oral Healthcare, Home Environment Care and Food & Beverages – and has some 8,200 employees worldwide.

## Continued progress

The year 2003 saw DAP turn in another strong performance, with profitability rising further. We retained and/or gained No. 1 or 2 market positions in over 75% of our targeted markets. We are the global market leader in male shaving, the US market leader in rechargeable electric toothbrushes, European brand leader in steam irons and European market leader in drip-filter coffee-makers. The year 2003 also saw a major effort to expand sales of our revolutionary Sonicare toothbrush from its original US home market to Europe and Asia Pacific, and to grow the Senseo coffee-maker business in Germany, France and the Benelux.

## Innovation and design

DAP is renowned for innovations that have changed consumers' lives. Numerous breakthrough products, such as the Philishave Cool Skin and Sensotec shavers and the Senseo coffee-maker, have made their mark, and our innovative product design has not gone unnoticed either, DAP products winning over 20 design awards over the past three years!

Major launches in 2003 included the skin-friendly Satin-Ice Optima epilator, the Intellicare range of intelligent steam-ironing systems, and the odor-free Essence deep-fat fryer.

DAP launched its *Break away and Excite* program in 2003 to further strengthen its leadership position and generate more 'break-away' concepts that go beyond satisfying consumers to actually exciting them. A special *Break away and Excite* day brought some 5,000 DAP employees together with a similar number of consumers all over the world to brainstorm on such concepts.

## Odor-free frying

Philips has extended its innovative Essence range of kitchen appliances with its most sophisticated and innovative deep-fat fryer to date. The Philips Essence Fryer offers up to 100% reduction in frying odors and grease particles thanks to its unique Active Air Control. Active Air Control is a closed system that works on the principle of condensation, allowing the consumer to fry foods without filling the kitchen with the smell of frying.



# Semiconductors

Philips Semiconductors' vision is of a world in which everyone can connect to information, entertainment and services. Within this 'Connected Consumer' environment, applications have to be underpinned by technology that enables convergence and information-sharing between devices in a world that is rapidly shifting from analog to digital.

We will achieve profitable growth by focusing on connected consumer applications, by further developing partnerships for manufacturing and technology, and by executing our customer intimacy strategy with leading customers in our selected high-growth markets.



Inaugural ceremony  
French President Jacques Chirac opens Crolles2.

Serving the consumer, communications, automotive and computing markets, Philips Semiconductors is a leading provider of silicon solutions for 'Connected Consumer' applications. Ranked among the world's top ten semiconductor manufacturers, the division has some 33,200 employees and a sales force delivering to more than 50 countries.

## 2003 in perspective

While there were a number of broader economic challenges throughout 2003, such as the Iraqi conflict and a weak US dollar, we did see some signs of recovery in the semiconductor industry. We continued to implement a number of measures initiated in 2002 with the aim of returning the division to profitability by the fourth quarter of 2003. These included further reducing R&D spending and manufacturing capacity, simplifying the organizational structure through site reductions, streamlining IT and delivery processes, increasing customer intimacy and realizing further design wins.

During the course of 2003 we closed two semiconductor fabrication plants in Albuquerque and San Antonio, reducing CMOS capacity by 20%. We also incorporated the Mobile Display Systems business, which includes Professional Speaker Systems, into the division. As a result, customers now

have a single source for complete and integrated solutions for the telecom and PDA markets.

We also made further progress with our program to partner with leading customers, content and service providers, the aim being to increase our share of business from key customers from 55% in 2001 to 70% by the end of 2006. We reached 61% by the end of 2003, from 58% at year-end 2002.

The number of design wins continued to rise in 2003, particularly for Nexperia systems solutions, which are being adopted by leading customers in mobile and consumer markets.

## Nexperia

Our Nexperia platform is designed to address the challenge of digital convergence. Nexperia is a platform of programmable ICs for multimedia applications that offer the 'next experience' in streaming media. Nexperia product families provide the flexibility needed for easy application differentiation and future-proof system solutions. Highly integrated, Nexperia products enable rapid application development and short time-to-market, allowing manufacturers to stay up to date with end-user demands in the highly



competitive consumer and communications markets. Each Nexperia product family is targeted at a specific range of applications.

Nexperia falls into two categories. The first, Nexperia Mobile, has been very successful. Samsung and Sony Ericsson have already adopted Nexperia, as have various OEMs like Bird, China's leading handset manufacturer, which shipped some 10 million mobile phones in 2003. The second is Nexperia Home, which is being adopted by leading consumer electronics manufacturers in areas such as TV and DVD recorders. Besides Philips, these include a large number of DVD recorder manufacturers such as BenQ, Humax and Daewoo.

Our Nexperia solutions are increasingly found in living room consumer electronics such as DVD recorders, LCD TVs and Digital TVs. By the end of 2003, seven out of ten DVD+RW video recorders sold worldwide were based on Nexperia technology. In audio, Philips continues to enhance consumers' listening experiences. One out of every three TVs in the world uses our audio amplifiers, while one out of every four 'home theater in a box' systems uses our Class-D amplifiers. And in the field of mobile communications our Nexperia System Solution has gained tremendous market traction.

### Enabling solutions

We have been successful in developing and implementing industry-standard technologies, not least in the area of wireless communications. We have

products that are 802.11b/a/g compliant as well as compliant with other wireless standards such as Bluetooth, NFC (Near-Field Communication) and RFID (Radio Frequency Identification). In the area of RFID, the number of Philips chips in the market is rapidly approaching the one billion mark, covering smart card, smart label and car access and immobilizer applications. Philips' MIFARE technology is the leading technology for contactless and dual-interface smart card applications, such as major electronic ticketing projects for public transport in London, Beijing, Seoul and Moscow.

In the smart label market, RFID is gaining momentum as the successor to product barcodes and is the driver for improved efficiencies in supply chain management. Leading global customers such as Toyota, Nestlé and Dell have implemented Philips' RFID technology for a variety of applications ranging from inventory tracking to quality management. We are also driving telecommunications standards, particularly in relation to our T3G joint venture with Datang and Samsung (the Chinese 3G TD-SCDMA standard).

In the automotive sector Philips has continuously gained market share over the last ten years. One out of three cars worldwide incorporates Philips car radio chipsets. One out of every five cars produced worldwide in 2003 had four ABS sensors from Philips. And one out of two cars produced in 2003 in Europe included Philips RF Access & Immobilization. In addition, Philips is active in various automotive consortia: the company is, for example,

a core member of the Flexray consortium that is developing a de-facto standard for x-by-wire systems, which are designed to make vehicle performance more reliable and therefore safer.

### Leveraging a capital-efficient manufacturing strategy

Forecasts for the semiconductor market vary widely, due to often unpredictable swings in demand. As a result, 2004 industry forecasts range from low double-digit growth to predictions of around 25% growth. It is in this context of uncertainty that Philips Semiconductors is adopting a capital-efficient manufacturing strategy in order to be more flexible and effective throughout

future industry cycles. This means that having rationalized our own wafer capacity, we are entering into partnerships and agreements with external foundries, allowing us to outsource a larger percentage of future capacity needs.

We are currently seeing the rise of a new form of 'virtual consolidation', which is changing the dynamics of our business. At Philips, we are benefiting from our technology partnership through our joint venture with STMicroelectronics and Motorola in Crolles, France. Together we have built a 12-inch CMOS facility, which has created pre-competitive advantages in terms of new thinking in R&D and breakthrough technologies such as 90 nm and 65 nm silicon.



### Highlighting flexibility

Starting in July 2003 in the US and in the fall in Europe and Asia Pacific, Philips Semiconductors launched a new advertising campaign featuring the division's latest Nexperia product solutions, e.g. DVD+RW, Cellular base-band and the Intelligent Bolt-on TV solution. The campaign is in line with Semiconductors' 'living technology' image campaign and features the stretch images that visualize the flexibility of Nexperia.

# Medical Systems

Inspired by a vision of 'healthcare without boundaries', Philips Medical Systems is reaching far beyond the conventional role of a supplier of medical equipment and systems. The division is striving for breakthroughs not only in diagnosis and treatment, but also in understanding the processes of disease to facilitate early prediction and detection.

Through partnerships with leading institutes and universities, Philips Medical Systems is looking to address fundamental issues that have a significant influence on patient outcomes and cost to society.

Philips Medical Systems seeks to achieve market share growth by means of a distinctive brand positioning and solutions that deliver clinical and operational excellence. The division strives to maximize efficiency and earnings by following a path of continuous cost and productivity improvements.

## Intera

The new Intera Achieva 3.0T magnetic resonance (MR) system for whole-body imaging has an acquisition speed that is 15 times faster than five years ago and markedly increased reconstruction speeds, enabling whole-body scans to be produced in a matter of minutes. A further benefit is the system's open, patient-friendly design.



With around 30,600 employees, more than half of them in the USA, 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, resuscitation products and healthcare information management, as well as a comprehensive range of customer support services.

## Operational improvement and efficiency

Along with the completion of the process of integrating the companies acquired in recent years, the focus in 2003 was on driving operational improvement and maximizing synergies and cost reductions.

Growth will be driven by continuing clinical innovations in combination with collaborative customer relationships. Our customers see us as a company that listens to their needs and works together with them as a team to develop and implement patient-centric and cost-effective solutions. This often involves carrying out joint research programs.

## Top rankings

Our advances were confirmed once again in October and November 2003 when we were awarded the highest rankings in 19 out of 24 product categories by MD Buyline, an independent US research company that advises healthcare providers on buying medical technology. Also, our patient monitoring products and services were designated No. 1 in 23 of 25 categories in IMV's annual medical technology survey, an unprecedented score.

## Innovations across all key modalities

Significant developments in diagnostic imaging technology provide substantial benefits in all key modalities, enabling healthcare providers to improve patient care while at the same time reducing costs. For example, the new Intera Achieva 3.0T magnetic resonance (MR) system for whole-body imaging has an acquisition speed that is 15 times faster than five years ago and markedly increased reconstruction speeds, enabling whole-body scans to be produced in a matter of minutes. With a design that is 40% shorter than that of competing products and only half their weight, this is the most compact system in its class, facilitating its integration in existing hospital

sites without the need for costly new building. A further benefit is the open, patient-friendly design, which contributes to an improved patient experience.

In the cardiovascular X-ray field the latest Integris Allura flat detector system features Philips' Xper concept, which allows cardiologists to customize their workflow in the cath lab with an intuitive, Philips-consistent user interface, smart integration features and preferred user settings. A further innovation in this system is the Xres real-time imaging technology, which delivers outstanding, noise-free image quality, for example with enhanced visualization of coronary arteries.

Philips is also advancing healthcare with a new 40-slice CT (computed tomography) scanner – the market's first with FDA (US Food & Drug Administration) clearance. Providing physicians with more useful information nearly 50 times faster than CT scanners of just five years ago, this clinical breakthrough opens new doors for assessing some of the most pressing healthcare conditions such as stroke, heart disease and lung cancer with unprecedented speed and accuracy.

In patient monitoring, new members of the market-leading range of Intellivue monitors were introduced. This helped to fuel further growth in revenues and margins, adding to the already very strong position in the top cardiac hospitals.

### Strategic alliances for paperless and filmless hospitals

In the fall of 2003, Philips Medical Systems announced an alliance with Epic Systems Corporation to provide enterprise software, medical imaging and monitoring IT solutions that integrate patient information enterprise-wide. This agreement combines Epic's strengths in patient-centric, enterprise-wide healthcare information systems with Philips' strengths in medical imaging, PACS and patient monitoring technology. The result – medical equipment integrated with enterprise software across departments, including at the point of care, offering a new level of clinical benefits.

### Personal healthcare

Philips' Personal Healthcare initiative offers consumers compelling technology solutions that will enable them to assume greater control of their own healthcare. One such solution is the HeartStart Home Defibrillator,



#### 40-slice CT

The new Philips 40-slice CT Brilliance system – the first of its kind – represents a clinical breakthrough, enabling healthcare providers to assess and treat conditions such as stroke, heart disease and lung cancer with unprecedented levels of speed and accuracy.



#### Integris Allura

The latest Integris Allura flat detector system features Philips' Xres real-time imaging technology, which delivers outstanding, noise-free image quality, for instance with enhanced visualization of coronary arteries.

designed specifically for home users to deliver a life-saving shock in the event of sudden cardiac arrest. Philips is also developing revolutionary telemonitoring solutions that will use broadband communication technology to bring personalized healthcare information and services directly to consumers' homes.

#### Molecular imaging

Focusing on advancing pre-clinical and clinical technologies, a further initiative was the setting-up of research collaborations in molecular imaging. By combining new molecular agents with advanced imaging tools, molecular imaging is creating a paradigm shift in healthcare by providing insight into specific molecular pathways in the body. Instead of conventional treatment of diseases after they have become established, molecular imaging holds the promise of detection, diagnosis and treatment at the earliest stages of disease development.

#### Long-term, collaborative customer partnerships

In November 2003, the division announced a 15-year, USD 50 million strategic alliance with The Cleveland Clinic Foundation (CCF), one of the world's leading healthcare institutions, which has the No. 1 heart program in the US, as ranked by U.S. News & World Report. The strategic alliance provides for Philips to be a preferred supplier of medical products and technologies, to utilize CCF's clinical expertise to carry out R&D in radiology and cardiology, and to have CCF serve as a global reference site for Philips' advanced technology.

At the St. Francis Health System in Indianapolis, USA, and Prince County Hospital on Prince Edward Island, Canada, Philips will provide all equipment and related services in a true partnership alliance. These accounts cover not only the supply

of diagnostic imaging, patient monitoring and IT systems, but also the delivery of lighting, domestic appliances and entertainment systems.

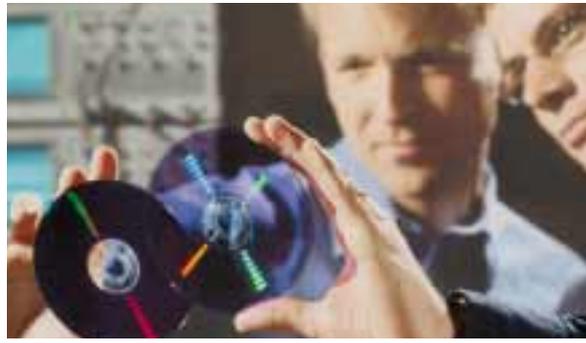
Other examples of this new capability include Lund's University Hospital in Sweden, where Philips won contracts to supply all CT and MR systems and to maintain and upgrade all the hospital's patient monitoring systems. And in Korea, Seoul's National University Hospital has awarded the country's largest-ever single medical equipment supply contract to Philips. This deal covers MR, CT, X-ray and angio systems, gamma cameras, ultrasound and monitoring systems and multi-year maintenance.

A key aspect of the Philips proposition to major healthcare providers is its multidisciplinary, company-wide approach. This meets the customers' wish to deal with a limited number of trusted partners who can offer a full capability in all the relevant areas – not only medical systems but also complete hospital equipment projects, including lighting, communications, security systems and entertainment systems.

Within Philips Medical Systems itself, cross-business initiatives are leading to the implementation of consistent user-interface concepts across imaging modalities. These increase physicians' effectiveness by providing the same 'look and feel', adapting to their preferences and moving with them to different locations. The same holds for the application of innovative imaging technologies in multiple modalities; for example the Xres technologies were originally developed for Philips' MR line by Philips Research, and have subsequently been implemented in the ultrasound product line and the new Integris flat detector system for cardiovascular X-ray systems.

# Miscellaneous

This sector comprises four main groups of activities: Corporate Technology (such as Philips Research, Intellectual Property & Standards, Philips Centre for Industrial Technology and Philips Design), Corporate Investments (such as Assembléon and Philips Enabling Technologies Group), Shared Service Centers and Other activities (such as Optical Storage and Navigation Technology).



## Double-layer DVD+R

At the CEATEC Japan 2003 exhibition, Philips demonstrated the world's first double-layer recordable DVD solution. Developed by Philips Research in cooperation with Mitsubishi Kagaku Media/Verbatim, the technology virtually doubles the data-storage capacity on DVD recordable discs to 8.5 Gbyte, while remaining compatible with existing DVD video players and DVD-ROM drives. The DVD+RW alliance has fully endorsed the technology and has finalized the double-layer DVD+R format book. Recorders for the PC and consumer electronics markets are expected to become available in the first half of 2004.

## Philips Research

Philips Research has a global presence, with laboratories spread over Europe, North America and Asia Pacific. The organization has some 2,400 employees worldwide.

Philips Research's main focus is on creating value by generating new technologies for the Philips businesses, and in so doing sustaining a strong intellectual property position: by year-end 2003 the Company had reached the landmark figure of 100,000 patent rights worldwide.

Tomorrow's world will be characterized by 'ambient intelligence', an environment in which technology resides invisibly in the background to offer the appropriate atmosphere and functionality when required. Inspired by this vision of tomorrow, people at Philips Research work on the enabling technologies to make this future happen – ranging from display, storage, connectivity and healthcare solutions to IC design and embedded systems.

Philips Research has strategic partnerships with the Philips product divisions and their key customers, as well as with world-class universities and technical/scientific institutes.

Furthermore, we also seek to leverage our capabilities and international presence to influence regional standards and markets.

## Technology incubator

Although the prime value creation mechanism of Philips Research remains the transfer of novel technologies to the various Philips businesses, in some cases establishing a new business may prove a better option. In 2003, Philips Technology Incubator was created with the aim of identifying such opportunities and helping transform these into new businesses. The excellent infrastructure offered by Philips Research, including access to a large pool of experts in different technology and business fields, gives these new businesses a flying start. Initiatives currently being explored include Handshake Solutions (clockless-IC design), Silicon Hive (reconfigurable computing), Polymer Vision (plastic electronic displays) and Home Dialogue Systems (speech/vision user interfaces).

## Handshake solutions for low-power chips

Philips Research has developed the most advanced technology available for the design of 'handshake circuits', which is a special



#### Electronic paper

With excellent readability, low power consumption and a thin and lightweight form factor, paper-like electronic ink displays are emerging as ideal candidates for integration into mobile devices. Philips and E Ink Corporation have been collaborating closely to bring this technology to the market. Philips plans full-scale commercialization of the world's first high-resolution electronic ink-based display modules in 2004.

class of clockless integrated circuits. Handshake circuits have great potential for low-power applications, because circuit elements are only activated when needed. Philips has already produced millions of ICs based on this design method, and is rapidly scaling up the amount of products and applications. An example of current use is in Philips Semiconductors' MIFARE ProX family of microcontrollers for smartcards.

#### Flat X-ray detector

Flat X-ray detectors based on large-area thin-film electronics are rapidly emerging to become the dominant technology for static and dynamic X-ray imaging, replacing today's X-ray films as well as bulky image intensifier/camera systems. They provide distortion-free and homogeneous images with high image quality at lower dose. After developing the fundamental technology, Philips Research was also closely involved in the development of products that are now being produced by Trixell (a joint venture of Philips, Siemens and Thales) and are supplied by Philips Medical Systems as part of their X-ray systems.

#### Open innovation

Excelling in areas like embedded systems, microsystems, nanotechnology, polymer science and broadband communication, Philips Research Eindhoven is at the heart of several networks of leading companies and research institutes designed to further the development of advanced technology domains and to promote the innovative strength of the region, which is already one of Europe's top three in terms of

innovation. Philips has also opened up its High-Tech Campus in Eindhoven to external companies, offering them a highly innovative infrastructure and active engineering support.

#### Philips Intellectual Property & Standards

Philips Intellectual Property & Standards (IP&S) is responsible for managing Philips' intellectual property portfolio. The activities of IP&S include the creation of all intellectual property rights, including patents, trademarks, designs, domain names and copyrights. In addition, IP&S plays a leading role in establishing standards in specific technical fields, such as optical storage and digital rights management, in close cooperation with other Philips businesses, Philips Research and third parties. IP&S also exploits Philips' technologies through the transfer or licensing of know-how and the associated intellectual property rights to third parties.

IP&S provides worldwide support to the Philips organization in all intellectual property matters related to the acquisition of licenses from third parties and transactions with customers, suppliers and other companies.

In 2003 the number of patent filings for new inventions was again stable at about 3,000. As a result of the high level of filings over the last three years Philips has reached the milestone of 100,000 patent rights worldwide, demonstrating the company's innovative strength.



### 50 years of design excellence

Each year Philips Design receives a variety of international design awards in various categories – including product design, graphic design, concept design and interface design. In the book *50 Years of iF – Now and Then*, recently published to celebrate the fiftieth anniversary of the iF Design Awards, Philips is ranked third out of 3,400 international corporations who have taken part in iF competitions, with a grand total of 365 awards. In 2003 one of the award winners was the Emotive Micro line of lifestyle-oriented micro audio systems.

### Centre for Industrial Technology

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, process technology, equipment technology, assembly and industrial development.

### Philips Design

In 2003, Philips launched its *One Design* initiative, which is intended to ensure that consumers recognize and experience the company as a single entity. *One Design* reaffirms Philips Design's responsibility for the creative direction of the company's

overall design identity through the full delivery chain of all design-related services.

Philips Design is dedicated to creating and adding real value by providing distinctive, innovative and cost-effective solutions through its proprietary High Design process. High Design is based upon in-depth research into people's behavior; their relationship with technology, socio-cultural dynamics and evolving lifestyles. The know-how gained is then fed into the innovation process, fostering cross-company synergies and opening up new business opportunities. Philips Design has some 450 professionals from over 30 countries located at 12 studios around the world.



### Successful by design

These products – all winners of major global design awards in 2003 – exemplify our commitment to offer our customers exciting, engaging and enabling solutions that make a genuine difference to their lives.



# Cooperative business activities and unconsolidated companies

Philips engages from time to time in cooperative activities with other companies. Philips' principal cooperative business activities and participating interests are set out below.

**LG.Philips LCD Co.** is a 50/50 manufacturing joint venture with LG Electronics of South Korea and is the world's No. 1 supplier of large-size TFT liquid-crystal display (LCD) panels. This joint venture has enabled Philips to become a leader in the area of active-matrix LCDs, a display technology that is rapidly migrating from notebook and desktop monitors to other areas, such as televisions.

**LG.Philips Displays** is a 50/50 joint venture with LG Electronics of South Korea and is a leading supplier of cathode ray tubes (CRTs) for televisions and desktop monitors. The joint venture combines the two companies' complementary strengths and creates cost synergy potential in the mature CRT market. The company is in the midst of a large restructuring program to address the structural overcapacity in the industry and to reduce its operational costs.

**Taiwan Semiconductor Manufacturing Company Limited (TSMC)** is a semiconductor foundry operation in which Philips currently holds 19.1% of the total number of outstanding common shares. TSMC is the world's largest dedicated semiconductor foundry, providing the industry's leading process technology and the foundry industry's largest portfolio of process-proven library, IP, design tools and reference flows. The company operates one advanced 300 mm wafer fab, five eight-inch fabs and one six-inch wafer fab. TSMC also has substantial capacity commitments at its wholly owned subsidiary, WaferTech, and its joint venture fab, SSMC. In early 2001, TSMC became the first IC manufacturer to announce a 90 nm technology alignment program with its customers. In November 2003, Philips sold 100 million American Depository Shares, each representing five

common shares in TSMC. The principal reasons for the shareholding are to secure a strategic supply of wafers, to share and exchange technology and manufacturing knowledge, and to share the risk of capital.

**Systems on Silicon Manufacturing Company (SSMC)**, a Singapore-based wafer fabrication firm, is a joint venture established by Philips (48%), Taiwan Semiconductor Manufacturing Company (TSMC: 32%) and the Economic Development Board of Singapore (EDB: 20%). The original USD 1.2 billion investment project led to the creation of a state-of-the-art wafer fabrication facility in Singapore's Pasir Ris Wafer Fab Park, capable of producing semiconductor wafers with advanced sub-micron process technologies. Construction of the SSMC fab was completed in record time, setting a new benchmark in the semiconductor industry. The principal reasons for the shareholding are to secure a strategic supply of wafers and to limit loading risks and share the risk of capital.

In the **Lumileds Lighting** 50/50 joint venture, Philips and Agilent Technologies have the complementary strengths and positions to successfully develop the market for LED-based lighting products. The product portfolio has been extended from LED traffic signal products to a variety of other applications, including automotive, signaling, contour lighting and signs, illumination and LCD backlighting, demonstrating both parties' confidence in the new technology. The operations are located in the USA, Malaysia and the Netherlands.

**Atos Origin** is a leading international IT services provider and a global supplier of business consulting and technology integration services. Atos Origin provides integrated design, build and operate solutions to a base of large clients in carefully targeted industry sectors in over 30 countries worldwide. At year-end 2003 Philips' share in Atos Origin amounted to 44.7%. In 2003, Atos Origin announced that it had agreed to buy

Schlumberger Sema in 2004 with cash and new shares. Consequently, Philips' stake will decrease from 44.7% to 31.8% and, based on current information, a dilution gain of approximately EUR 120 million is expected to be reported in the first quarter of 2004.

#### InterTrust Technologies Corporation

In January of the year under review Philips (49.5%) and Sony Corporation of America (49.5%), a subsidiary of Sony Corporation, and certain other investors (1%) acquired InterTrust Technologies Corporation. InterTrust is a leading developer of DRM (Digital Rights Management) technologies and holds a key DRM patent portfolio, which covers a wide variety of secure digital distribution technologies, including digital media platforms, web services and enterprise infrastructure. An important objective of the acquisition is to ensure wider access to InterTrust's key DRM intellectual property rights, so as to enable broad DRM-protected distribution of digital content for the benefit of content owners, service providers, device makers as well as consumers and enterprises.

**FEI Company** is a US-based company in which Philips holds 26% of the outstanding shares. FEI is the leading supplier of Structural Process Management™ solutions to the world's technology leaders in the fields of semiconductors, data storage and biological structures.

Philips Medical Systems and Rabobank Group's subsidiary De Lage Landen International set up a venture to provide financing throughout the United States for the purchase of the full range of diagnostic imaging equipment produced by Philips Medical Systems. The venture is called **Philips Medical Capital** and is based in Wayne, Pennsylvania. De Lage Landen owns a majority stake (60%) in the venture and has operational control. The venture became operational in the fourth quarter of 2002.

Philips Medical Systems and Société Générale have signed a memorandum of understanding to set up a venture to provide financing to customers in a number of European countries for the purchase of the full range of diagnostic imaging equipment produced by Philips Medical Systems. The venture is expected to become operational during the first half of 2004.

By year-end 2003 the **Corporate Venturing** portfolio comprised some 20 companies in which Philips has a minority stake and, in some cases, an active business relationship. The Company has stopped acquiring interests in new ventures under this Corporate program and is currently re-evaluating its position in this area.



# Report on the performance of the Philips Group

1. The following Management Report is based on the consolidated financial statements and should be read in conjunction with the other financial information.
2. Philips' consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP).
3. The Group financial statements, as prepared under US GAAP, differ in certain respects from generally accepted accounting principles in the Netherlands (Dutch GAAP). The difference represents goodwill amortization and income recognition in respect of reversals of securities impairments under Dutch GAAP. Income from continuing operations determined in accordance with Dutch GAAP was a profit of EUR 705 million in 2003, compared with a loss of EUR 3,602 million in 2002. These aggregate amounts result in basic earnings per common share of a profit of EUR 0.55 in 2003 and a loss of EUR 2.83 in 2002. Please refer to the specific section of the consolidated financial statements for a description of the primary differences between Dutch GAAP and US GAAP and the earnings per common share information.
4. 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'.

# Group performance

## The year 2003

- **Net income of EUR 695 million, helped by a strong contribution from unconsolidated companies**
- **Comparable sales growth of 4%, reversing the trend of the previous two years**
- **Cost reduction programs surpass target of EUR 1 billion savings**
- **DAP and Lighting continue solid performance; significant improvement at Medical Systems**
- **Semiconductors profitable in the 4th quarter after significant restructuring**
- **Positive cash flow from operating activities of EUR 2.0 billion; net debt reduced to EUR 2.8 billion**

## Net income

in millions of euros	2001	2002	2003
Sales	32,339	31,820	<b>29,037</b>
Income (loss) from operations	(1,395)	420	<b>488</b>
as a % of sales	(4.3)	1.3	<b>1.7</b>
Financial income and expenses	(915)	(2,227)	<b>(244)</b>
Income taxes	428	(27)	<b>15</b>
Results unconsolidated companies	(608)	(1,346)	<b>506</b>
Minority interests	15	(26)	<b>(56)</b>
Cumulative effect of change in accounting principle	-	-	<b>(14)</b>
<b>Net income (loss)</b>	<b>(2,475)</b>	<b>(3,206)</b>	<b>695</b>
Per common share - basic	(1.94)	(2.51)	<b>0.54</b>
- diluted	(1.94)	(2.51)	<b>0.54</b>

## Special items affecting income

in millions of euros	2001	2002	2003
<b>Special items:</b>			
affecting income from operations	(1,235)	(40)	<b>(431)</b>
affecting financial income and expenses	(526)	(1,888)	<b>146</b>
income taxes related to special items	313	127	<b>100</b>
affecting results relating to			
unconsolidated companies	(248)	(1,613)	<b>(80)</b>
<b>Total special items</b>	<b>(1,696)</b>	<b>(3,414)</b>	<b>(265)</b>

## Summary

Led by the United States, the markets in 2003 showed clear signs of recovery. The revival was more modest in Europe. Due to the weaker US dollar, the improving market trends are not reflected in nominal sales. More importantly, comparable sales increased by 4%, reversing the downward trend of the previous two years.

During the economic downturn of the last years, we focused on cost and asset management and on improving our fundamental business processes. As a result, we see better operating margins in all our sectors (except Miscellaneous). On top of that, the performance in the second half of the year shows that income is growing in line with comparable sales growth.

Net income improved to EUR 695 million, helped by the absence of impairment charges on financial assets. Income from operations improved by EUR 68 million although it was negatively impacted by a lower level of sold businesses and real estate (EUR 445 million) and an increase in pension costs (EUR 312 million).

Income from unconsolidated companies amounted to EUR 506 million, led by a strong contribution from the LCD joint venture with LG Electronics. Positive one-time results from our shareholding in Atos Origin (EUR 68 million) and the sale of TSMC shares (EUR 695 million) were offset by impairment and restructuring charges related to the LG.Philips Displays joint venture (EUR 828 million).

Philips generated EUR 1,992 million positive cash flow from operating activities in 2003. Net capital expenditures of EUR 856 million were in line with 2002, both years being half the 2001 level. The net debt to group equity ratio was further improved to 18:82, compared with 27:73 at the end of 2002.

## Euro rate against the US dollar



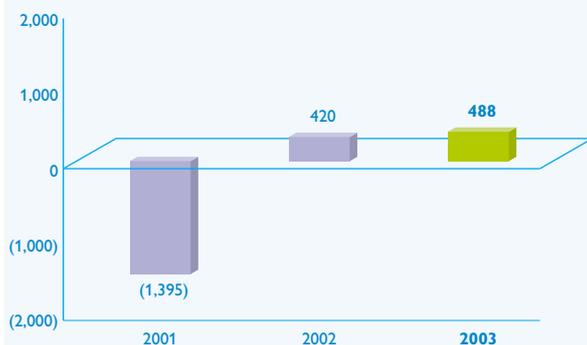
## Recovery of technology markets in 2003

		2001	2002	2003*
PCs	million units	135	137	153
	% growth	(4)	1	12
Cellular phones	million units	400	407	470
	% growth	(4)	2	15
Cons. electronics	value in billions of euros	94	95	88
	% growth	(2)	1	(7)
Semiconductors	value in billions of US dollars	139	141	166
	% growth	(32)	1	18

\* provisional data

## Income (loss) from operations

in millions of euros



## Sales

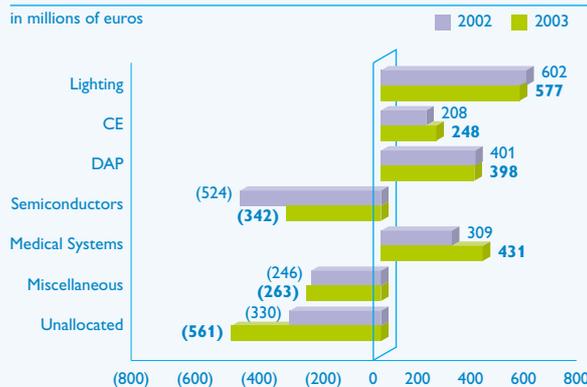
Sales in 2003 totaled EUR 29,037 million, 9% less than in 2002. Due to the depreciation of the US dollar in 2003 the improving market trends are not reflected in nominal sales: slightly more than half of our business is done in the US dollar and US dollar-related currencies. Translation of these sales into euros reduced total sales by 10%. Various divestments had a negative effect of 3%. Comparable sales increased by 4%, reversing the downward trend of the two previous years.

On a comparable basis, sales in all sectors excluding Miscellaneous expanded, predominantly in Semiconductors and Medical Systems. Semiconductors (11%) benefited from a market that improved rapidly in the second half of the year and from the increased Nexperia product sales, especially in mobile communications. Strong comparable sales growth in Medical Systems (7%) was the result of increasing revenue synergies in the sales organization. DAP posted comparable growth (3%) based on successful new product introductions. Consumer Electronics' growth (2%) was mainly driven by Television and DVD in the second half of the year. Lighting's growth (2%) exceeded the soft lighting markets.

## Income from operations

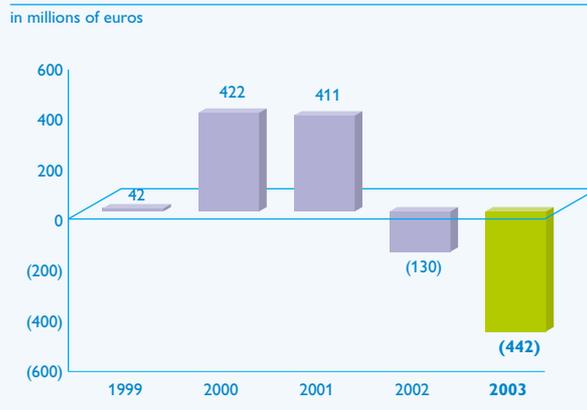
Cost savings resulted in a significant increase in income from operations. The improvement was partly offset by an increase in pension costs amounting to EUR 312 million and special charges of EUR 431 million, while in 2002 net charges totaled EUR 40 million. Over the last two years overhead cost reductions yielded savings of EUR 425 million to date, while Medical Systems delivered savings of EUR 342 million. Including savings on R&D and other projects, the overall cost reduction program surpassed the target of EUR 1 billion savings by the end of 2003.

## Income (loss) from operations per sector



Medical Systems improved its income from operations by EUR 122 million compared to the previous year as cost and revenue synergies started to take effect. The division recorded a goodwill impairment charge of EUR 139 million for MedQuist in 2003. Despite difficult market conditions, Lighting and DAP were able to mirror the previous year's outstanding results. Product innovation, improved customer service and supply chain performance, together with the continuing focus on cost management, drove the margin improvements.

## Total pension (costs) / benefits



Semiconductors increased profitability during the year as a result of higher sales, lower R&D expenditures and the benefits of the wafer-fab restructurings. Semiconductors reduced capacity in order to be better aligned with market demand, which resulted in restructuring and impairment charges of EUR 290 million, compared to charges of EUR 167 million the previous year. Benefits of the restructuring became visible in the fourth quarter, with the division posting a EUR 166 million profit.

Consumer Electronics' income from operations increased by EUR 40 million as a result of higher license income. The division suffered from increased competition and accelerated product cycles, but margins increased throughout the year, led by strong sales of televisions. The fourth quarter was clearly better than the previous year. During 2003 the division launched a renewal plan to further improve profitability.

## Special items affecting income (loss) from operations

in millions of euros

	2001	2002	2003
Sale of businesses and real estate	295	569	124
Restructuring and impairment charges	(1,093)	(513)	(555)
Acquisition-related charges	(331)	(84)	-
Write-off of acquired in-process R&D	(106)	(12)	-
<b>Total</b>	<b>(1,235)</b>	<b>(40)</b>	<b>(431)</b>

The Company slowed down its divestment program in 2003 in response to difficult market conditions. Vocon/Telephony and the remaining part of Philips Contract Manufacturing Systems were the only businesses that were divested in 2003, which resulted in a gain of EUR 35 million. Sale of real estate resulted in a gain of EUR 88 million.

## Estimated annualized future savings

in millions of euros	2002		2003	
	restructuring and impairment charges	savings	restructuring and impairment charges	savings
Lighting	13	10	27	25
Cons. Electronics	74	58	58	50
DAP	9	6	-	-
Semiconductors	167	133	290	185
Medical Systems	43	-	146	35
Miscellaneous	197	114	34	35
<b>Philips Group</b>	<b>503</b>	<b>321</b>	<b>555</b>	<b>330</b>

## Restructuring and impairment charges

The Company's continued efforts to realign its portfolio, further improve efficiency and develop a more flexible cost base led to restructuring and impairment charges of EUR 555 million, net of a release of EUR 83 million. The most significant restructuring and impairment charges for 2003 were:

- closing of the semiconductor fabrication facilities in San Antonio and Albuquerque, and other smaller projects to adjust capacity and bring it in line with demand (EUR 290 million)
- transfer of television production from Dreux and of monitor production from Hungary and Taiwan to China, along with some other projects for CE (EUR 58 million)
- several programs at Lighting to close subscale facilities and improve operating efficiencies (EUR 27 million)
- MedQuist impairment of EUR 139 million due to lower expectations for the business
- restructuring and impairment charges in the Miscellaneous sector of EUR 34 million, mainly related to impairment on a building.

The expected annual savings from the above restructurings are estimated at around EUR 330 million.

## Financial income and expenses

in millions of euros	2001	2002	2003
Interest expenses (net)	(391)	(384)	<b>(328)</b>
Impairment of securities	(526)	(1,955)	-
Income from non-current financial assets	67	107	<b>148</b>
Other	(65)	5	<b>(64)</b>
<b>Total</b>	<b>(915)</b>	<b>(2,227)</b>	<b>(244)</b>

## Results relating to unconsolidated companies

in millions of euros	2001	2002	2003
LG.Philips LCD	(210)	169	<b>382</b>
LG.Philips Displays	(175)	(558)	<b>(796)</b>
SSMC	(84)	(54)	<b>(7)</b>
Others	(139)	(903)*	<b>927**</b>
<b>Total</b>	<b>(608)</b>	<b>(1,346)</b>	<b>506</b>

\* includes Atos Origin's impairment charge of EUR 921 million

\*\* includes EUR 695 million gain from sale of TSMC shares

## Special items affecting results relating to unconsolidated companies

in millions of euros	2001	2002	2003
Restructuring/impairment charges	(89)	(301)	<b>(417)</b>
Investment impairment charges	(119)	(1,305)	<b>(431)</b>
Gain from sales of shares	20	5	<b>715</b>
Dilution gains (losses)	(60)	(12)	<b>53</b>
<b>Total</b>	<b>(248)</b>	<b>(1,613)</b>	<b>(80)</b>

## Financial income and expenses

The reduction in outstanding net debt from EUR 5,251 million in 2002 to EUR 2,804 million in 2003 was the main reason for the lower interest expenses. The sale of stakes in ASML, Vivendi Universal and JDS Uniphase resulted in gains totaling EUR 146 million in 2003. Other financial income and expenses represented a loss of EUR 64 million in 2003, mainly caused by an IT deficiency in an automated currency conversion system.

## Income taxes

Income taxes represented a benefit of EUR 15 million in 2003, compared to an expense of EUR 27 million in 2002. Excluding non-tax deductible impairment charges for MedQuist and non-taxable gains on the sale of shares in JDS Uniphase, ASML and Vivendi Universal, the tax benefit in 2003 corresponds to an effective tax benefit of 6%, compared with a projected effective tax charge for 2003 of 25%. The positive deviation is the consequence of an improved performance in certain fiscal jurisdictions, amongst others Navigation Technologies Corporation (NavTech) (EUR 149 million), which resulted in a release of valuation allowances that more than offset additions to provisions to cover fiscal contingencies. For 2004 an estimated effective tax rate of 30% on pre-tax income is expected.

## Results relating to unconsolidated companies

The operating results of most unconsolidated companies improved in 2003 compared to the previous year. During the second half of 2003 the LCD industry witnessed capacity shortages due to the explosive rise in demand. LG.Philips LCD benefited from timely investment in new factories and became the market leader in terms of both revenue and volume. Average prices of LCD panels increased by over 35% during the year. Philips' 50% share in the LCD joint venture resulted in a contribution to net income of EUR 382 million.

LG.Philips Displays had to reorganize its activities to face a tough and declining market. Largely due to the success of LCD products, demand for products based on cathode ray tubes (CRTs) is declining and the industry is facing structural overcapacity.

### Global CRT display market forecast



Along with other major players, LG.Philips Displays is reducing its capacity and has taken restructuring and impairment charges of EUR 417 million (Philips' share). In view of the deteriorated CRT market, the Company reassessed the value of its investment in the CRT joint venture with LG Electronics, which resulted in a further impairment charge of EUR 411 million at year-end.

Driven by increased demand in the second half of the year, capacity utilization at Taiwan Semiconductor Manufacturing Company (TSMC) improved to 101% in the fourth quarter, compared with 66% the previous year. The operating results of TSMC almost doubled from the previous year. The contribution to Philips' net income included a gain on the sale of shares amounting to EUR 695 million.

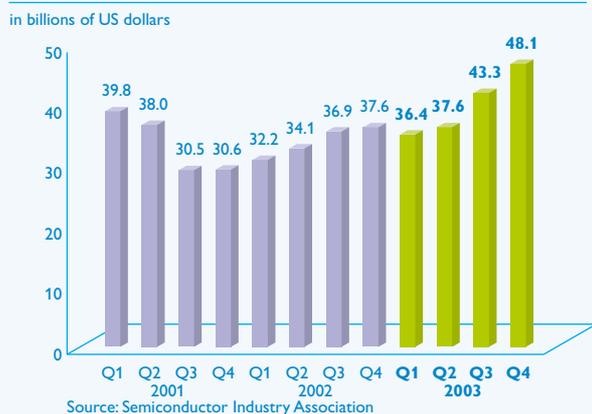
### Large-area TFT LCD market



The joint venture with STMicroelectronics and Motorola for the development of new semiconductor technology in Crolles, France, advanced to the test production stage during the year. Philips' share in the costs since then amounted to EUR 45 million.

Results from unconsolidated companies included a non-cash dilution gain of EUR 68 million related to Atos Origin. This gain was due to an increase in the value of Philips' equity in Atos Origin as a result of a mandatory conversion into stock of Atos Origin's convertible bonds, issued in connection with an acquisition.

### World semiconductor markets

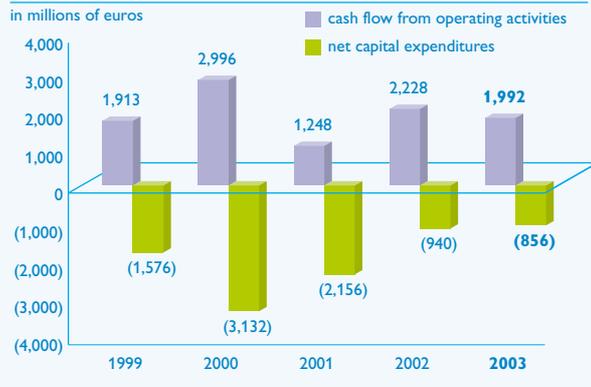


In January 2003, the Company acquired 49.5% of InterTrust, which develops and licenses intellectual property relating to Digital Rights Management (DRM) and trusted computing. InterTrust performed in line with expectations.

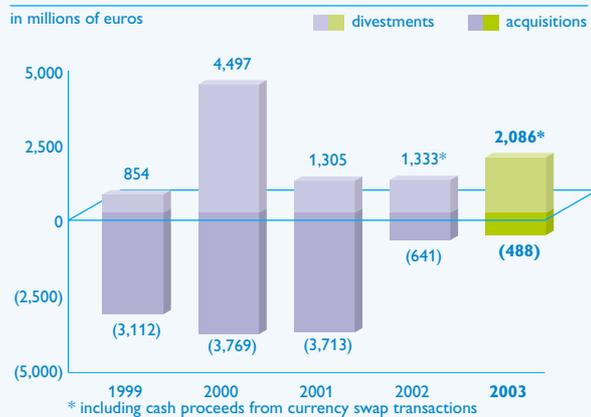
### Minority interests

In 2003 the share of minority interests in the income of group companies amounted to EUR 56 million, compared with a share in the income of EUR 26 million in 2002. Minority interests included EUR 24 million in respect of improved results at NavTech, which were partly attributable to a tax benefit.

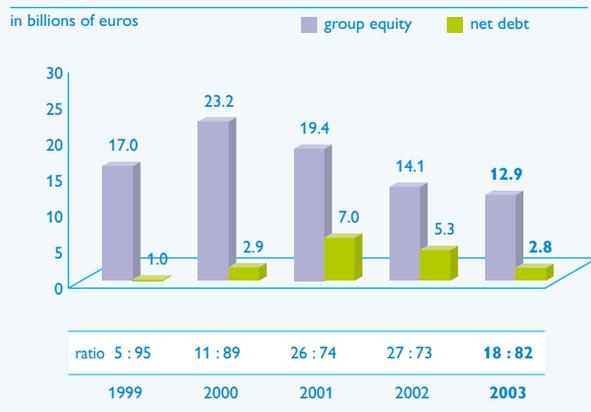
## Cash flows from operating activities versus net capital expenditures



## Cash flows from divestments and acquisitions



## Net debt to group equity



## Cash flows

Cash flow from operating activities amounted to EUR 1,992 million compared to EUR 2,228 million in 2002. The decrease was mainly attributable to a lower level of improvement of working capital, which had already been reduced substantially in 2002. Inventories as a percentage of sales at the end of 2003 stood at 11.0%, slightly improved as compared to the previous year (11.1%).

Cash used for investing activities in 2003 consisted mainly of:

- net capital expenditures of EUR 856 million, somewhat below the 2002 level;
- acquisitions totaling EUR 488 million, of which the most significant were the 49.5% investment in InterTrust (EUR 202 million), Crolles2 (EUR 99 million) and a loan to the 50% Lighting joint venture Lumileds (EUR 54 million);
- EUR 2,086 million cash proceeds. Main items relate to the sale of TSMC shares for EUR 908 million, the redemption of preference shares by TSMC (EUR 357 million), EUR 272 million for the sale of shares in Vivendi Universal, ASML and JDS Uniphase, and the receipt of EUR 391 million following the resetting of currency swaps.

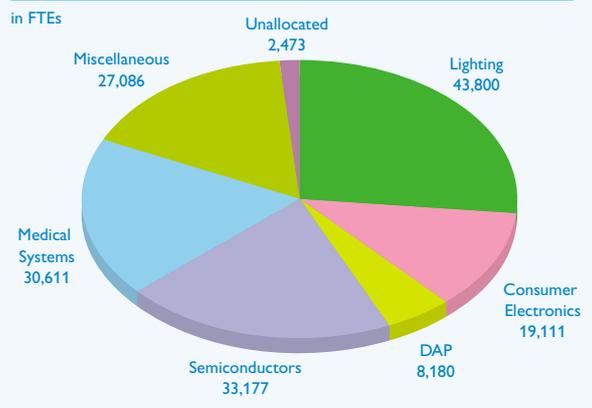
Net cash flow used for financing activities amounted to EUR 1,355 million. Philips shareholders were paid EUR 460 million of dividend, and debt was reduced by EUR 944 million, primarily due to a one-year-early redemption of a EUR 1 billion floating rate note.

## Financing

During 2003, Philips was able to reduce its net debt by EUR 2,447 million to EUR 2,804 million. The net debt to group equity ratio was reduced to 18:82, compared to 27:73 at year-end 2002.

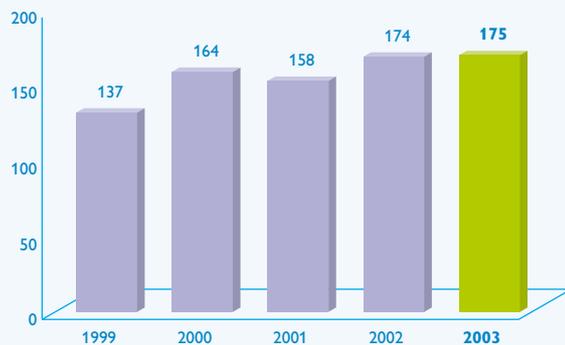
Stockholders' equity decreased by EUR 1,156 million to EUR 12,763 million at year-end 2003. Currency translation effects of EUR 1,652 million and a reduction of retained earnings by EUR 460 million from a dividend payment were only partly offset by the positive net income and other comprehensive income related to securities.

## Headcount per sector at year-end 2003



## Sales per employee

amounts in thousands of euros



## Employment

The number of employees at the end of December 2003 totaled 164,438, a decline of 5,649 from December 31, 2002. The reduction was most obvious in the area of manufacturing, as a result of greater use of outsourcing.

The largest reductions occurred at Lighting (2,859) and at Semiconductors, due to the closing of the San Antonio and Albuquerque sites. Moreover, the sale of the remainder of PCMS and the streamlining of activities in Corporate Investments resulted in a headcount reduction of 843 and 347 respectively.

In geographic terms, the headcount decreased in Western Europe and North America, offset by new hirings in Eastern Europe and Asia Pacific.

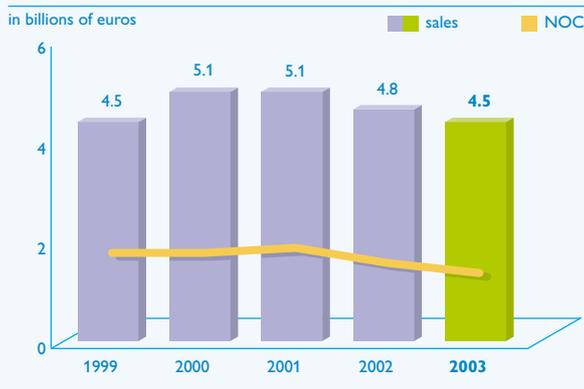
The number of temporary employees increased.

Despite the decline of the US dollar, the upward trend in sales per employee continued in 2003.

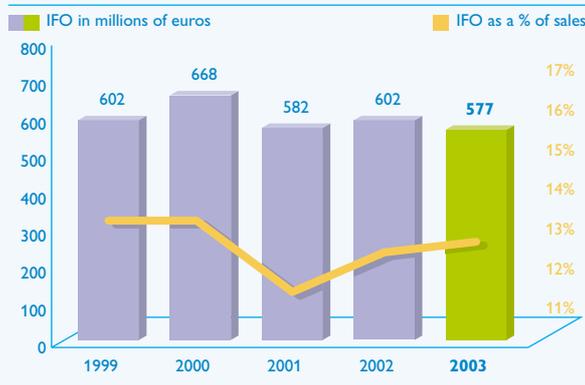
## Lighting: key data

in millions of euros			
	2001	2002	2003
Sales	5,083	4,845	4,522
Sales growth			
% nominal	1	(5)	(7)
% comparable	0	(2)	2
Income (loss) from operations	582	602	577
as a % of sales	11.4	12.4	12.8
Special items included in IFO	(18)	(14)	(14)
as a % of sales	(0.4)	(0.3)	(0.3)
Net operating capital (NOC)	1,979	1,723	1,521
Number of employees (FTEs)	47,922	46,870	43,800

## Lighting sales and net operating capital (NOC)



## Lighting income from operations (IFO)



## Market developments

The lighting market was generally soft over the past year. However, automotive and special lighting markets held up well, while LED technology also continued to develop at a fast pace. The Asia Pacific lighting market showed the fastest growth.

## Strategy

The Lighting division's strategy is to focus on end-user-driven innovation, marketing excellence, delivery reliability and people, while pursuing a policy of continuous improvement and strict control of costs and assets. It seeks to increase volumes in high-end products and aims to excel in innovative new products, for example HID, automotive and UHP lamps. Innovation is key for Lighting to expand its leading position in lighting systems for fast-growing consumer electronics applications (video projection systems) and to develop its solid-state lighting (LED) activities in conjunction with Lumileds, the 50/50 joint venture with Agilent Technologies. Growth is to be achieved by working with leading key accounts, enhancing the position in the value chain towards professional customers and end-users, and expanding in the fast-growing economies, especially China.

## Financial performance

Despite the generally weaker markets, comparable sales increased by 2%, fuelled by increases at Automotive & Special Lighting and Lighting Electronics. Sales in Asia Pacific and North America rose and European levels recovered, while demand in Latin America remained weak. Lighting is benefiting from focused marketing management, tight cost control and increasing volumes in high-end products. Net restructuring charges of EUR 27 million mainly related to projects in India, Canada and Venezuela. The Lumileds joint venture, an unconsolidated company, achieved substantial increases in sales and posted an operating profit.

# Consumer Electronics

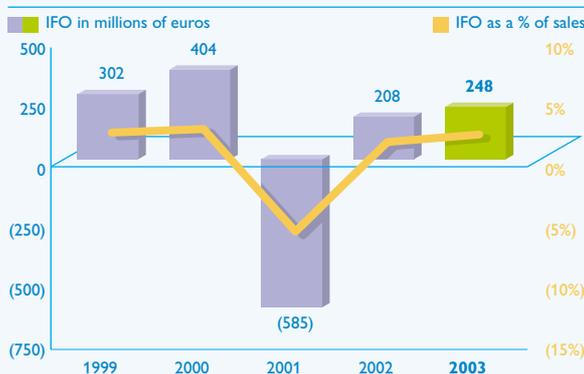
## Consumer Electronics: key data

in millions of euros			
	2001	2002	2003
Sales	10,633	9,855	<b>9,188</b>
Sales growth			
% nominal	(15)	(7)	<b>(7)</b>
% comparable	(15)	(4)	<b>2</b>
Income (loss) from operations	(585)	208	<b>248</b>
as a % of sales	(5.5)	2.1	<b>2.7</b>
Special items included in IFO	(493)	(14)	<b>(31)</b>
as a % of sales	(4.6)	(0.1)	<b>(0.3)</b>
Net operating capital (NOC)	655	46	<b>(82)</b>
Number of employees (FTEs)	29,645	21,018	<b>19,111</b>

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



## Consumer Electronics income from operations (IFO)



## Market developments

The increasing velocity of the innovation-to-commoditization cycle is challenging the entire industry. Moreover, markets are witnessing increased competition with the entrance of PC suppliers, leading to further convergence. In dollar terms, markets stabilized after two years of decline. Recovery became visible in the second half of the year, strongly supported by LCD, television and DVD sales. Monitor markets experienced an accelerated shift from CRT to LCD.

## Strategy

Consumer Electronics (CE) has been repositioned for future growth, having migrated from analog to digital, from manufacturing to marketing, and from a broad to a more focused product portfolio. CE will continue to focus on its Connected Planet vision, establish partnerships with leading retailers, enter into innovative alliances and introduce new sales channels. CE aims to make the organization more market-oriented and less complex in order to achieve EUR 400 million savings on a run rate basis by the end of 2005. The profitability target is 4% to 4.5% operating margin, of which 2% will be generated by Licenses. CE is further reducing its asset base by outsourcing and shifting its manufacturing to lower-cost countries.

## Financial performance

Comparable sales were up slightly (2%) after years of decline, and in line with market growth. Nominal sales were heavily impacted by the lower US dollar. Growth was strong in Asia Pacific (17%). The second half of the year saw growth, with Television, LCD Monitors, DVD and GSM in particular posting improved results. Generally, margins were under pressure, especially in the first half of the year. Innovative new products helped Television to increase margins during the year. Income from operations excluding Licenses amounted to a loss of EUR 49 million. Net restructuring charges totaled EUR 58 million, and mainly related to Television (Dreux) and Monitors. At year-end working capital was negative for the first time in the division's history. Driven by past-use payments of EUR 121 million, Licenses' income increased to EUR 297 million. CD-R/RW and DVD programs were the main contributors.

# Domestic Appliances and Personal Care

## DAP: key data

in millions of euros			
	2001	2002	2003
Sales	2,224	2,273	<b>2,131</b>
Sales growth			
% nominal	6	2	<b>(6)</b>
% comparable	0	6	<b>3</b>
Income (loss) from operations	334	401	<b>398</b>
as a % of sales	15.0	17.6	<b>18.7</b>
Special items included in IFO	(4)	(12)	-
as a % of sales	(0.2)	(0.5)	-
Net operating capital (NOC)	652	529	<b>464</b>
Number of employees (FTEs)	9,527	8,766	<b>8,180</b>

## Market developments

Global economic weakness, low consumer confidence and the effect of SARS negatively affected consumer spending in the first half of the year. However, markets in China rebounded strongly in the second half. The domestic appliances market witnessed aggressive marketing investments during the year 2003. The shaving business, particularly in North America, experienced intensified competition.

## Strategy

Domestic Appliances and Personal Care delivers a wide range of products that are used by consumers on a daily basis to manage their homes and enhance personal wellness. To this end, the division focuses on breakthrough innovations designed to delight consumers and to generate profitable growth. The division intends to expand its portfolio with sustainable, differentiated appliance-consumable propositions. It also intends to step up its marketing investments to generate top-line growth resulting in an improved bottom line. DAP plans to extend the reach of its Oral Healthcare products globally.

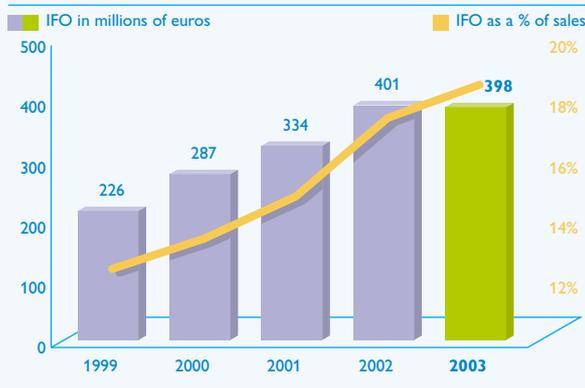
## Financial performance

Despite market weakness and a weakening US dollar, DAP was able to mirror the previous year's excellent result. Comparable sales growth was 3%. Oral Healthcare showed strong growth of 24%, and Food & Beverage set the pace for the industry with its 6% growth, both on a comparable basis. Profitability in 2003 increased from 17.6% to 18.7%. Higher margins and strict cost control enabled higher profitability despite lower nominal sales. Continued focus on asset management has led to a lower net operating capital and strong cash flow.

## DAP sales and net operating capital (NOC)



## DAP income from operations (IFO)



# Semiconductors

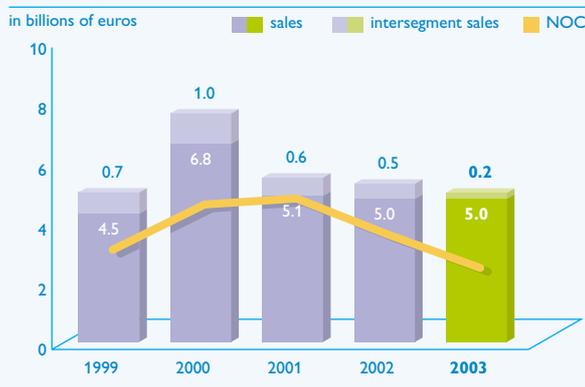
## Semiconductors: key data

in millions of euros			
	2001	2002	2003
Sales	5,094	5,032	<b>4,988</b>
Sales growth			
% nominal	(26)	(1)	<b>(1)</b>
% comparable	(28)	2	<b>11</b>
Income (loss) from operations	(716)	(524)	<b>(342)</b>
as a % of sales	(14.1)	(10.4)	<b>(6.9)</b>
Special items included in IFO	(237)	(160)	<b>(279)</b>
as a % of sales	(4.7)	(3.2)	<b>(5.6)</b>
Net operating capital (NOC)	4,993	3,814	<b>2,676</b>
Number of employees (FTEs)	35,956	34,225	<b>33,177</b>

## Utilization rate Semiconductors



## Semiconductors sales and net operating capital (NOC)



## Market developments

While there were a number of broader economic challenges throughout 2003, such as the Iraq conflict, SARS and a weak US dollar, the semiconductor markets recovered in the second half of the year. The growth in 2003 in USD terms was 18%, mainly driven by Asia Pacific. The television market showed weakness during the first half of 2003, impacting the sale of TV solution products. Strong growth was achieved in the wireless communication segment (above 20%) and the computing segment (approximately 15%). The market for standard products also grew. The mobile phone market ended the year at a level of 470 million pieces. The mobile displays market experienced an accelerated shift from monochrome to color, the latter now accounting for more than 60% of the market.

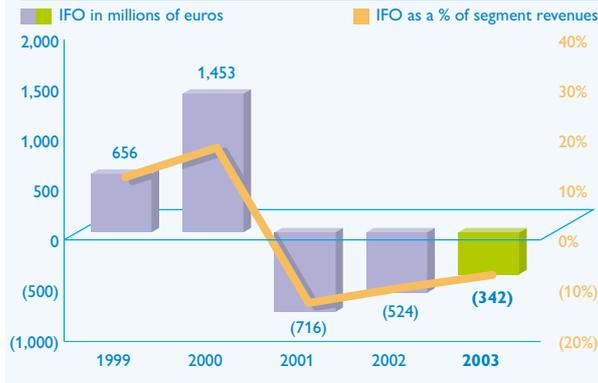
## Strategy

Semiconductors is actively managing a balanced portfolio spanning emerging, mature and multi-market products, and is servicing the consumer, communication, automotive and computing markets. The focus in the coming period will be on the development of Nexperia-based customer solutions that combine semiconductors, software and services. In this respect the division aims to grow particularly in DVD+RW, LCD TV and communication products.

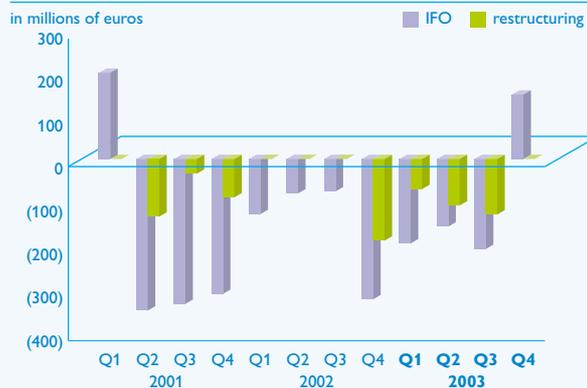
Semiconductors has adopted a capital-efficient manufacturing strategy in order to be more flexible and effective throughout future industry cycles. Having rationalized its own wafer capacity, it will outsource a larger percentage of future capacity needs. In 2003 the division reduced R&D, IT and infrastructure costs significantly and extended the useful life of its facilities to further lower the break-even point. Business and sales staff will be concentrated to a greater extent in the Asia Pacific region.

The division also partners with leading customers, content and service providers, the aim being to increase share of business from key customers from 55% (in 2001) to 70% by the end of 2006. It is already benefiting from a technology partnership with STMicroelectronics and Motorola at Crolles.

## Semiconductors income from operations (IFO)



## Semiconductors IFO and restructuring



The division will continue to invest in more advanced capacity through SSMC, which will be consolidated in early 2004 following the application of new accounting standards.

### Financial performance

Semiconductors' share of the market it serves declined over the year from 5.3% to 4.6%. The loss of share occurred primarily in the first half of the year. However, based on successful consumer and communication sales, the division managed to improve its market share from 4.5% in the third quarter to 5.0% in the fourth quarter. The utilization rate increased continuously through the year to reach a level of 84% in the fourth quarter. Consumer and Mobile Communications posted strong growth. Mobile Display Systems sales increased by 31%, mainly due to the accelerated adoption of color displays in new handsets. In volume terms, MDS increased its market share by 4%.

Income from operations in the fourth quarter totaled EUR 166 million. The profit was the result of increased sales, lower R&D spending and the benefits of the wafer-fab restructuring. Net restructuring and impairment charges totaled EUR 290 million for the year. Net operating capital continued to decrease. Net capital expenditures were maintained at a low level of EUR 205 million. In addition, the cash flow used for investing activities related to Crolles2 recorded by the Philips Group amounted to EUR 99 million.

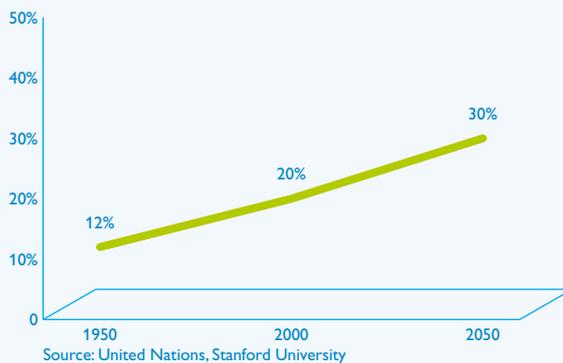
# Medical Systems

## Medical Systems: key data

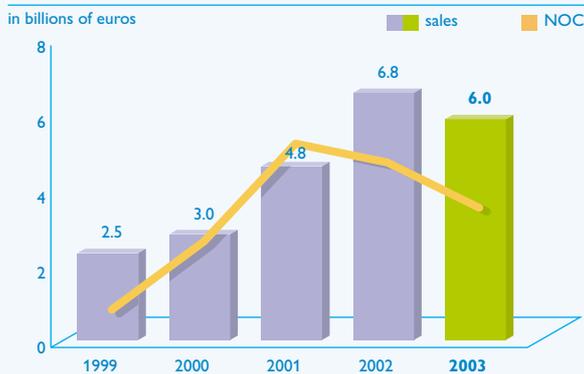
in millions of euros			
	2001	2002	2003
Sales	4,834	6,844	<b>5,990</b>
Sales growth			
% nominal	59	42	<b>(12)</b>
% comparable	9	5	<b>7</b>
Income (loss) from operations	(163)	309	<b>431</b>
as a % of sales	(3.4)	4.5	<b>7.2</b>
Special items included in IFO	(454)	(126)	<b>(147)</b>
as a % of sales	(9.4)	(1.8)	<b>(2.5)</b>
Net operating capital (NOC)	5,418	4,849	<b>3,671</b>
Number of employees (FTEs)	30,993	31,027	<b>30,611</b>

## Demographics driving future demand

% of people over age 60, Western world



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



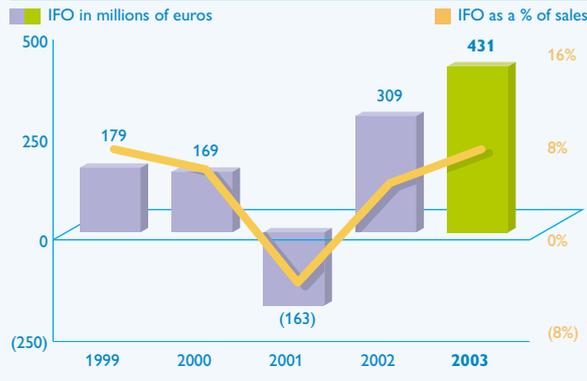
## Market developments

Expressed in local currencies, all Medical Systems' markets grew, except for Europe. Growth was fueled by new technologies for faster, earlier and more accurate diagnoses, as well as for new diagnostic procedures (e.g. for heart disease and cancer). In the USA, new hospital construction is creating demand for larger, multi-year arrangements. Leading hospitals are also seeking research partnerships to develop next-generation medical procedures. Large-scale genomic and proteomic research projects are being launched in order to enhance the understanding of disease on a cellular level. This is expected to lead to new procedures to detect and treat disease very early, thus reducing chronic disease, improving patients' quality of life and reducing expensive treatments. It is expected that this will create a new dynamic in the market over the next several years.

## Strategy

Medical Systems' strategy is aimed at maintaining its leadership in many modalities and in cardiology and critical care, while growing market share continuously in radiology and healthcare IT. This will be achieved by an innovation program that focuses on clinical excellence and product rejuvenation. This is illustrated by the introduction of new families of high-speed, high-performance CT and MR scanners in 2003. Philips is also expanding its service offering in order to increase customer contracts. In IT, a strategic alliance with Epic, the highly respected North American healthcare IT company, was announced. In response to the market demand for large, multi-year partnerships a dedicated group was established, which concluded many significant deals with leading healthcare enterprises, such as the Cleveland Clinic. In molecular medicine a number of strategic partnerships with highly innovative start-ups were established to develop early-detection molecular-diagnostic procedures. In financial terms Medical Systems continued on its path of continuous improvement towards its EBITA target of 14% of sales in 2004.

### Medical Systems income from operations (IFO)



### Medical Systems Quarterly comparable sales growth 2002-2003\*



### Financial performance

Sales increased by 7%, excluding the effect of the divestment of Health Care Products (HCP) in 2002 and currency movements. Sales were strong at Patient Monitoring, Medical IT and Customer Services. All regions contributed to the comparable sales growth. Income from operations came to EUR 431 million, including an impairment charge of EUR 139 million for MedQuist and net restructuring charges of EUR 7 million. In addition, a valuation adjustment of EUR 35 million, related to the alignment of inventory valuations across the Medical Systems business, impacted income from operations unfavorably. Cardiac and Monitoring Systems, Ultrasound and Healthcare IT were the main drivers of income improvements in 2003. Positive synergy effects yielded EUR 342 million savings, close to the target of EUR 350 million. Supply chain management resulted in a EUR 248 million reduction in working capital, mainly in net inventories.

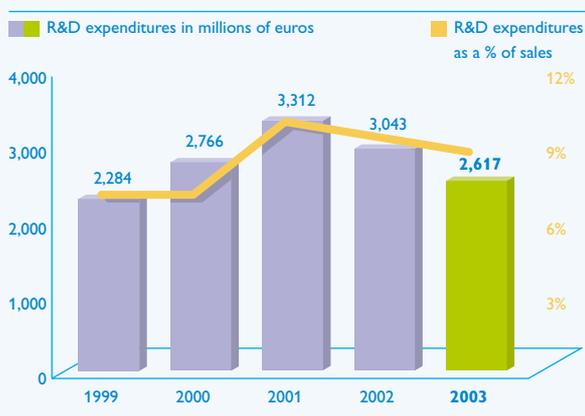
## Miscellaneous: key data

in millions of euros			
	2001	2002	2003
Sales	4,471	2,971	2,218
Sales growth			
% nominal	(46)	(34)	(25)
% comparable	(24)	(4)	(5)
Income (loss) from operations	(726)	(246)	(263)
as a % of sales	(16.2)	(8.3)	(11.9)
Special items included in IFO	8	285	39
as a % of sales	0.2	9.6	1.8
Net operating capital (NOC)	477	(181)	150
Number of employees (FTEs)	29,137	23,866	27,086

## Miscellaneous sales and net operating capital (NOC)



## Total Philips R&D expenditures



## Introduction

This sector comprises four main groups of activities: Corporate Technology (such as Philips Research, Intellectual Property & Standards, Philips Centre for Industrial Technology and Philips Design), Corporate Investments (such as Assembléon and Philips Enabling Technologies Group), Shared Services for IT, Finance, HRM and Real Estate, and Other activities (Optical Storage and NavTech). In addition, there are activities that are being redesigned, or disentangled and prepared for divestment.

## Corporate Investments

Within the Corporate Investments portfolio, most businesses improved, except for the semiconductor- and technology-related activities, such as Assembléon and Philips Enabling Technologies Group. Additional restructurings have been carried out in order to align capacity with demand and to ensure that full advantage is taken of any upswing in economic activity.

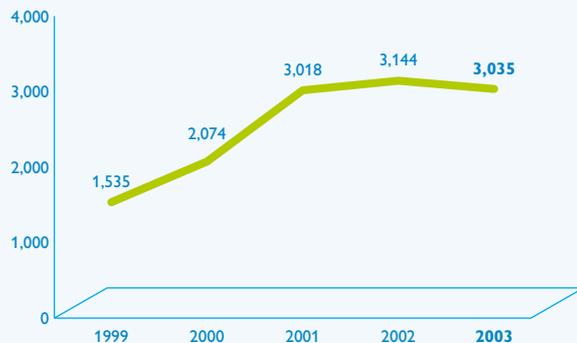
Due to the economic downturn and the absence of a genuine revival in the technology sector, the divestment program was slowed down. The Vocon/Telephony business was divested in 2003, resulting in a EUR 20 million gain.

## Corporate Technology

The loss from operations related to Corporate Technology increased during 2003. This was largely due to the higher level of expenditures made in start-up projects such as LCoS and PolyLED. In the last quarter of 2003 CINEOS Microdisplay Television, based on LCoS technology, was successfully introduced in the United States. In 2003, PolyLED completed the installation of a color production line. The first commercial products will be brought to market in the course of 2004. Research costs in Corporate Technology were in line with the previous year. Total Philips R&D expenditures decreased to EUR 2.6 billion from EUR 3.0 billion in 2002. In spite of lower R&D expenditures Philips was able to maintain its high level of first filings of patents. The high level of patent filings over the last three years has resulted in a portfolio which in 2003 surpassed the level of 100,000 patent rights worldwide.

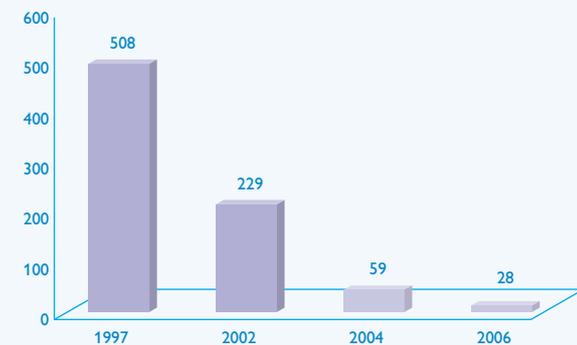
## Philips reaches 100,000 patents

number of filed patents, last five years



## Number of different ERP systems used in Philips

number of ERPs



## Unallocated: key data

in millions of euros	2001	2002	2003
Corporate and regional overheads	(411)	(332)	<b>(307)</b>
Pensions/postretirement benefit costs	290	2	<b>(254)</b>
Income from operations	(121)	(330)	<b>(561)</b>
Number of employees (FTEs)	5,463	4,315	<b>2,473*</b>

\* Reclassification to Shared Services in Miscellaneous in 2003: 1,623

## Shared Service Centers

In order to build a more cost-effective and process-focused organization, the Company created three new shared service centers (Accounting & Reporting Services, People Services and IT Services) during the year, in addition to the centers for Global Real Estate and Non-Product-Related Purchasing.

Start-up costs for the new shared service centers and special items in Global Real Estate resulted in a loss for the shared service centers of EUR 23 million. The special items included an impairment loss for a building (EUR 30 million), which was more than offset by gains on the sale of real estate (EUR 46 million).

## Other activities

The restructuring programs restored Optical Storage to profitability in 2003, with an income from operations of EUR 51 million (driven by its Automotive Playback Modules and Audio/Video operations), which represents an improvement of EUR 253 million.

NavTech is a leading provider of digital map information and related software and services used in a wide range of navigation mapping and geographic applications. Over several years NavTech invested in building a database with a high level of detailed road and related information. The demand for road navigation systems is still increasing. In 2003 sales rose by EUR 67 million to EUR 242 million, while income from operations increased by EUR 45 million to EUR 56 million.

In addition the Company released a provision amounting to EUR 50 million related to a sale of shares in NavTech to an investment consortium in 1999.

## Corporate & Regional Overheads

Corporate overhead costs continued to be aggressively reduced during 2003, offset by a large increase in pension costs. Pension costs increased by EUR 256 million in 2003, and include postretirement benefit costs relating to inactive employees, which are not attributable to the product divisions. The costs of the corporate center – including the Company's global brand management and sustainability programs – as well as country and regional overhead costs, are not attributable to the product sectors but are reported separately under Unallocated.

## Sales per geographic area



## Income (loss) from operations per geographic area

in millions of euros

	2001	2002	2003
Europe/Africa	(497)	888	916
North America	(851)	(521)	(411)
Latin America	(13)	23	(27)
Asia Pacific	(34)	30	10
<b>Total</b>	<b>(1,395)</b>	<b>420</b>	<b>488</b>

## Performance by region

Sales in 2003 in Europe declined by 5%, partly due to the effect of divestments and weaker currencies (e.g. the pound sterling). Semiconductors and Medical Systems recorded sales growth, while sales were weaker in Consumer Electronics and Miscellaneous. The Netherlands, Germany and the UK recorded the weakest sales performance, partly offset by a strong rise in Eastern Europe.

Sales in North America decreased by 19%, mainly due to the weaker US dollar and the divestment of HCP in 2002. On a comparable basis, sales increased by 5%. This was attributable to all sectors except Semiconductors. Sales in Latin America declined by 18%, mainly as a result of significantly weaker currencies following the collapse of the Argentinian and Venezuelan economies.

Sales in Asia Pacific increased by 1%, hampered by the negative effect of weaker currencies following the decline of the US dollar. On a comparable basis, sales grew by 16%, headed by soaring sales in China (34% higher). Excluding the effects of changes in consolidations and currencies, sales in all sectors except DAP increased strongly, in particular at Semiconductors, in the second half of the year.

The improvement in income from operations in 2003 on a global level was mainly attributable to Europe and North America. Despite the considerable improvement in North America, this region is still loss-making, due to restructuring charges at Semiconductors and an impairment charge for MedQuist.

## Proposed dividend to shareholders of Royal Philips Electronics

A proposal will be submitted to the General Meeting of Shareholders to declare a dividend of EUR 0.36 per common share (EUR 461 million). Pursuant to article 35 of the Articles of Association, and with the approval of the Supervisory Board and the Meeting of Priority Shareholders, the remainder of the income for the financial year 2003 has been retained by way of reserve. In 2002 a distribution was made of EUR 0.36 per common share from the other reserves.

### Subsequent events

On September 22, 2003, Atos Origin announced that it had signed an agreement to acquire the core IT services activities of Schlumberger Sema from Schlumberger. The transaction has been approved by Atos Origin's shareholders meeting in January 2004. As consideration for the purchase, Atos Origin will deliver 19.3 million shares to Schlumberger together with EUR 400 million in cash. The transaction, based on the volume-weighted average price of Atos Origin shares for the 20 days preceding September 19, 2003 (EUR 45.90), values the purchase consideration at EUR 1,287 million. As a result, Philips' shareholding will be further diluted from 44.7% to 31.8%, resulting in an expected non-cash and non-operating dilution gain of approximately EUR 120 million (based on Atos Origin's September 2003 equity position), to be recorded in Philips' results for the first quarter of 2004.

On January 30, 2004 the Company reached an agreement in principle with the trade unions in the Netherlands that will result in reduced pension obligations and a lower risk profile for the Company's pension exposure. The agreement still needs to be ratified by the unions' members. In view of these remaining uncertainties the final impact of the agreement on the pension obligations and future pension costs of the Company cannot yet be determined.

## Outlook

Building on the achievements of 2003, we expect to sustain our improvement momentum. We will keep growing our Medical business, as we move toward achieving our 2004 profitability target of 14% EBITA.

Now that we have achieved break-even in CE in the US in the fourth quarter, one of our top priorities will be to achieve full profitability in this business in 2004, through our CE business renewal program, which aims to trim an additional EUR 400 million off of CE's cost structure by the end of 2005.

With an emerging turnaround in the markets for our semiconductor products, we expect to benefit from additional design wins for our Nexperia solutions, and anticipate a solid performance in this business this year.

We will implement our growth plans for Asia, and in particular China, in the context of our management agenda in 2004, as the Company explores avenues for meeting consumers' demands in these major developing markets.

In Lighting and DAP we target additional markets for our innovative products while further optimizing our operations.

Measures to make Philips a more truly market-driven company will continue, including a greater focus on the corporate brand.

Further savings on indirect costs will be pursued as part of the One Philips program. During 2004 realizing our management agenda will bring us closer to our financial and strategic objectives.

February 6, 2004

*Board of Management*



# 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 the former Philips Components division.

Gerard Kleisterlee is also Chairman of the Supervisory Board of Eindhoven University of Technology and non-executive director of Vivendi Universal.



## **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.

Jan Hommen is also Chairman of the Board of the Philips US subsidiary MedQuist and member of the Supervisory Board of the former Philips subsidiary Atos Origin. He is also a member of the Supervisory Boards of Royal Ahold and TPG and Chairman of the Supervisory Board of the University Hospital of Maastricht.



## **Ad Huijser** 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 Huijser 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.

Ad Huijser is also a member of the Supervisory Board of CQM (Centre for Quantitative Methods).



## **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:



## **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.



## **Jan Oosterveld** 1944, Dutch

**Member of the GMC since May 1998; responsible for Corporate Strategy since 1997 and the Asia Pacific region since 2003**

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 managing director in 1995.



## **Arthur van der Poel** 1948, Dutch

**Member of the Group Management Committee since May 1996; responsible for Sustainability and Quality Policy since 2002**

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 and a member of the Board of Management from May 1998 until April 2003.



## **Scott McGregor** 1956, American

**Member of the GMC since January 2002 and President/CEO of the Semiconductors division since 2001**

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.



## **Andrea Ragnetti** 1960, Italian

**Member of the GMC since January 2003 and Chief Marketing Officer since 2003**

Andrea Ragnetti holds a degree in political science from Perugia University. He began his career in marketing at Procter & Gamble in 1987. In 1993 he joined Joh. A. Benckiser, becoming marketing vice-president, a position he held until 1997. He joined Telecom Italia in 1998 as executive vice-president of marketing for its Mobile division and took up a similar position with its Consumer division a year later.



## **Daniel Hartert** 1958, German

**Member of the GMC since August 2003 and Chief Information Officer since 2002**

Daniel Hartert graduated in Computer Science and Business Administration in 1986. In the first six years of his professional career he held various technical positions with Robert Bosch GmbH and VLSI Technology GmbH in Munich. In 1992 he joined Bertelsmann AG as IT Director of its European music business. In 1995 he moved to New York as International CIO of Bertelsmann Music Group, before returning to Germany four years later to become Bertelsmann CIO and member of the Executive Board of Bertelsmann's Direct Group. In 2001 he was appointed to the Executive Board of Arvato, the Services Division of Bertelsmann.



**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.



**Johan van Splunter** 1945, Dutch

Member of the GMC since August 2003 and President/CEO of the Domestic Appliances and Personal Care division since 2003

Johan van Splunter studied Business Economics at the University of Amsterdam. He joined Philips in 1969, holding positions in product management, marketing and general management in the fields of personal care and consumer electronics. In 1985 he was appointed Managing Director of Grundig Appliances in Germany and later became a member of the Board of Management of Grundig AG. In 1997, Johan van Splunter was named CEO of Philips South Africa. From October 2001 to December 2002, while in his position as Regional Executive, he was also CEO of Philips in Singapore.



**Rudy Provoost** 1959, Belgian

Member of the GMC since August 2003 and CEO of Philips Consumer Electronics Global Sales and Services since 2003

Rudy Provoost holds degrees in Psychology and Business Administration from the University of Gent. He began his career in 1984 with Procter & Gamble Benelux. In 1987 he joined Canon Belgium, in the field of sales and marketing, becoming General Manager of Marketing for all business operations in 1989. In 1992 Rudy Provoost joined Whirlpool Belgium as Managing Director, going on to become Vice President Whirlpool Brand Group Europe in 1999. He joined Philips in October 2000, when he was appointed Executive Vice President of Philips Consumer Electronics in Europe.



**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.



**Barbara Kux** 1954, Swiss

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

Barbara Kux holds an MBA from INSEAD. She began her career with Nestlé Germany as marketing manager in 1979. In 1984 she joined McKinsey, handling global assignments in strategy and business transformation. Five years later she joined ABB as Vice President responsible for the company's entry into Central and Eastern Europe. In 1993 she returned to Nestlé as Vice President of the company's Central and Eastern Europe region. In 1999 she joined Ford Europe as Executive Director responsible for capturing corporate synergies and establishing common business processes and structures across all key functions, including procurement.



**Theo van Deursen** 1946, Dutch

Member of the GMC since April 2003 and President/CEO of the Lighting division since 2003

Theo van Deursen joined Philips in 1973 after graduating in Electronics and Business Administration at Eindhoven University of Technology. Since then, he has held a number of key management positions, including CEO of the Lighting Electronics and Automotive & Special Lighting business groups. In 2002 he was entrusted with responsibility for the dissolution of the Components division. In 1985 he graduated from IMD's Executive MBA program and later complemented this study with an Executive MBA from the University of Virginia.



**Frans van Houten** 1960, Dutch

Member of the GMC since August 2003 and CEO of the Consumer Electronics Business Groups since 2003

Frans van Houten holds a degree in Economics, Marketing and Business Management. He joined Philips in 1986, working in sales and marketing, before moving to the US in 1992 to become CEO of Philips Airvision, a small in-flight entertainment start-up. From 1993 to 1996 he was Vice President Global Marketing and Sales of the Communication Network Systems division at PKI in Germany. In 1996 he joined Consumer Electronics (CE), setting up the Disc Systems business. In 1998 he became COO of the Digital Video Group in Palo Alto, California, before moving to Singapore in 1999 as Executive Vice President of CE's country organizations and businesses in the Asia Pacific and Middle East & Africa regions. In 2002 he became General Manager of Global Business Creation for CE.

# 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 of Global Crossing Inc., 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



**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.



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

Member of the Supervisory Board since 1999; second term expires in 2007

Former Chief Executive Officer of RoyalVendex 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, RWV, DHV, Agfa Gevaert, De Persgroep, Fraport, Munich Re and Anglo American



**J.M. Thompson** 1942, Canadian\*\*

Member of the Supervisory Board since 2003; first term expires in 2007

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



**C.J.A. van Lede** 1942, Dutch\*\*

Member of the Supervisory Board since 2003; first term expires in 2007

Former Chairman of the Board of Management of Akzo Nobel and currently Chairman of the Supervisory Board of the Dutch Central Bank, member of the Supervisory Boards of Akzo Nobel, Heineken, KLM, Scania, Reed Elsevier, Sara Lee Corporation, Air Liquide, and Chairman of the Board of Directors of INSEAD.

\* Member of the Audit Committee

\*\* Member of the Remuneration Committee

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

# Supervisory Board Report

## General

The supervision 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 two-tier structure prescribed by 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. It is empowered to recommend to the General Meeting of Shareholders persons to be appointed as members of the Supervisory Board or the Board of Management. Major management decisions, including the Group strategy, require the approval of the Supervisory Board. The Supervisory Board determines the remuneration of the members of the Board of Management. While retaining overall responsibility, the Supervisory Board assigns certain of its tasks to three permanent committees: the Corporate Governance and Nomination & Selection Committee, the Remuneration Committee and the Audit Committee. The separate reports of these committees are part of this report and published below.

As in 2002, with the US Sarbanes-Oxley Act, there were again developments on corporate governance in 2003. As part of the worldwide developments in this field, on December 9, 2003, a Dutch Corporate Governance Code was published. In several meetings, the Supervisory Board was informed about and discussed the consequences of this code – which was previously published in draft form – for the Company. Disclosure of the application of the code's principles and best practices will be required for the fiscal year 2004. In line with the Company's improved corporate governance in the last few years, Philips addresses the way it intends to further implement its overall corporate governance structure in this report (please refer to pages 146-159 of the separate booklet entitled 'Financial Statements and Analysis').

## Meetings of the Supervisory Board

The Supervisory Board met six times in the course of 2003, including a two-day meeting on strategy; all of its members participated in five or more of these meetings. The members of the Board of Management were present at the meetings of the Supervisory Board except in matters regarding the composition and functioning of the Supervisory Board and its members. The Supervisory Board also met without the members of the Board of Management being present when they discussed the composition of 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 and other members of the Supervisory Board had regular contact with the President/CEO and other members of the Board of Management 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, technology, financial, economic, social and legal aspects of international business and government and public administration. The Supervisory Board further aims to have available appropriate experience within Philips by having one former Philips executive as a member 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 eight members. At the General Meeting of Shareholders held on March 27, 2003 Mr J.M. Hessels was re-elected and Messrs J.M. Thompson and C.J.A. van Lede were elected to the Supervisory Board. At the 2004 General Meeting of Shareholders the present term of Mr K.A.L.M. van Miert will end. In view of the knowledge, experience and contribution he brings to the Board and the Audit Committee, we, in agreement with the Meeting of Priority Shareholders, shall make a proposal at the General Meeting of Shareholders to be held on March 25, 2004 to re-elect Mr Van Miert.

In agreement with the Meeting of Priority Shareholders, we shall also make a proposal at the 2004 General Meeting of Shareholders to elect Mr E. Kist as a member of the Supervisory Board as from July 1, 2004. Mr Kist (1944) is currently Chairman of the Executive Board of Amsterdam-based ING Group. Through the years, he has held several managerial positions within the ING Group, including a 3-year term in Washington D.C. as President of ING's US insurance operations. He is a board member of several Dutch organizations such as the Association of Insurers, the Confederation of Dutch Employers, the Netherlands' Red Cross and the National Fund for Aid to Victims. Internationally, he is a board member of the International Insurance Society in New York, the Peace Palace in The Hague and a member of the Geneva Association. Mr Kist will retire as Chairman of the Executive Board of ING Group as of June 1, 2004. Besides his managerial business experience, the Supervisory Board bases its recommendation to the General Meeting of Shareholders to appoint Mr Kist as a member of the Supervisory Board on his knowledge and experience of the financial and economic aspects of international business.

The remuneration of the members of the Supervisory Board is determined by the General Meeting of Shareholders of the Company. In accordance with the articles of association, the Supervisory Board has determined 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 116 and 117 of the separate booklet entitled 'Financial Statements and Analysis'.

#### **Report of the Corporate Governance and Nomination & Selection Committee**

The Corporate Governance and Nomination & Selection Committee consists of the Chairman and Vice-Chairman/Secretary of the Supervisory Board. In line with the New York Stock Exchange listing rules and other developments in the field of corporate governance, the Committee reviews the corporate governance principles applicable to the Company at least once a year, and advises the Supervisory Board on any changes to these principles as it deems appropriate. In 2003, the Committee discussed several times the consequences for the Company of the new Dutch Corporate Governance Code, the final version of which was published on December 9, 2003. A full description of the Company's current corporate governance structure is published on pages 146 - 159 of the booklet 'Financial Statements and Analysis'.

In accordance with its charter, incorporated in the Rules of Procedure of the Supervisory Board, the Corporate Governance and Nomination & Selection Committee consulted in 2003 with the President/CEO and other members of the Board of Management on the election or re-election of candidates for Supervisory Board membership and candidates to fill current and future vacancies on the Board of Management and the Group Management Committee, and prepared decisions and advised the Supervisory Board on the candidates for appointment. As of 2004, it will further supervise the policy of the Board of Management on the selection criteria and appointment procedures for Philips Senior Management.

In respect of the Board of Management and Group Management Committee, the following changes occurred in 2003.

Mr A.P.M. van der Poel relinquished his membership of the Board of Management and became Senior Vice-President and a member of the Group Management Committee on a part-time basis as of May 1, 2003. He will leave the Company on April 1, 2004.

As of January 1, 2003, Mr A. Ragnetti has been appointed as Chief Marketing Officer, a member of the Group Management Committee and Senior Vice-President.

Mr A.H.A. Veenhof resigned as CEO of the Domestic Appliances and Personal Care division and a member of the Group Management Committee as of May 1, 2003.

Mr D.C.M. Hamill stepped down as CEO of the Lighting division as of July 1, 2003, and resigned as a member of the Group Management Committee as of December 7, 2003.

As of May 1, 2003, Mr J.A. van Splunter succeeded Mr Veenhof as CEO of the Domestic Appliances and Personal Care division, and effective August 1, 2003 he has been appointed as a member of the Group Management Committee and Senior Vice-President. As of April 1, 2003, Mr T.W.H. van Deursen has been appointed as a member of the Group Management Committee and Senior Vice-President, and as of July 1, 2003, he succeeded Mr Hamill as CEO of the Lighting division. As of August 1, 2003, Mr R. Provoost has been appointed as CEO of Consumer Electronics Global Sales and Service, a member of the Group Management Committee and Senior Vice-President, and as of the same date, Mr F.A. van Houten has been appointed as CEO of Consumer Electronics Business Groups, a member of the Group Management Committee and Senior Vice-President. Also as of August 1, 2003, Mr D.U. Hartert, Chief Information Officer, has been appointed as a member of the Group Management Committee and Senior Vice-President.

As of October 1, 2003, Mrs. B. Kux has been appointed as Chief Procurement Officer, a member of the Group Management Committee and Senior Vice-President.

#### Report of the Remuneration Committee

The Remuneration Committee, currently consisting of four members who are listed on page 64, is responsible for preparing decisions of the Supervisory Board on the remuneration of members of the Board of Management and the Group Management Committee. It met four times in the course of 2003.

The Remuneration Committee proposes to the Supervisory Board the remuneration policies for members of the Board of Management – to be submitted to the 2004 General Meeting of Shareholders for approval – and other members of the Group Management Committee and reports annually to the Supervisory Board on the implementation of this remuneration policy. The Supervisory Board, through the Remuneration Committee, implements this policy and determines on the basis of this policy the remuneration of the individual members of the Board of Management and other members of the Group Management Committee. The Supervisory Board aims to have available appropriate experience within the Remuneration Committee. Currently, no member of the Remuneration Committee is a member of the management board of another listed company.

The Remuneration Committee has been assigned its tasks as laid down in the Charter of the Remuneration Committee that forms part of the Rules of Procedure of the Supervisory Board. The Committee reviewed its Charter and will adjust it in line with best practice.

### 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. The main focus is on companies with headquarters based in Europe. Total individual compensation is aimed at the median of comparable companies in the general industry. For that purpose, benchmark research is carried out each year on a great number of Dutch companies (among others Shell, Unilever and Akzo Nobel), other European companies (e.g. Siemens, Nokia, STM and Alcatel) and over ten global multinational companies (e.g. IBM, Intel and Motorola) of comparable size, complexity and international scope in the general industry. Additional market data on hundreds of companies in the general industry is provided by a number of independent external expert advisers.

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 restricted shares and stock options.

The total cash pay-out in any year is the sum of the base salary received in the year concerned and the bonus pay-out related to the previous year. For those current Board members who were also Board members on April 1, 2002, the variable performance-based-reward part and the total cash pay-out in 2003 (and previous two years) is presented in the table below.

Members Board of Management <sup>2)</sup>	Variable remuneration as a % of total remuneration <sup>1)</sup>			Total cash pay-out		
	2001	2002	2003	2001	2002	2003
G.J. Kleisterlee	73.3%	66.7%	<b>49.1%</b>	970,295 <sup>6)</sup>	807,069	<b>1,185,890</b>
J.H.M. Hommen	70.6%	66.7%	<b>49.3%</b>	1,005,917	672,573	<b>973,463</b>
G.H.A. Dutiné	– <sup>4)</sup>	0% <sup>3)</sup>	<b>55.2%</b> <sup>5)</sup>	n.a.	375,000 <sup>7)</sup>	<b>661,750</b>
A. Huijser	– <sup>4)</sup>	0% <sup>3)</sup>	<b>53.3%</b> <sup>5)</sup>	n.a.	337,500 <sup>7)</sup>	<b>581,444</b>
Total				5,066,533 <sup>8)</sup>	3,143,206 <sup>8)</sup>	<b>3,841,276 <sup>8)</sup></b>

1) Restricted shares based upon actual grant price and stock options based upon Black & Scholes value of the actual grant price in particular year (see Note 32 stock based compensation, Financial Statements and Analysis)

2) Reference date for Board membership is December 31, 2003

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

4) Not a member of the Board of Management in 2001

5) Including 9 months Annual Incentive related to period as member of the Board of Management (date of appointment April 1, 2002)

6) Annual incentive related to period April – December 2000

7) Related to period April – December 2002

8) Including former members not listed in table

### 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.

	Maximum base salary		
	2001	2002	2003
Board of Management			
Chairman	986,972	1,012,000	<b>1,020,000</b>
CFO/Vice-Chairman	–	835,000	<b>840,000</b>
CFO	635,292	–	–
Member	635,292	651,000	<b>660,000</b>

Normally (and subject to the decision by the Supervisory Board) the base salary will reach the maximum function-related salary level over a maximum 3-year period from appointment. In line with market developments shown by the benchmark research and the additional market studies, the maximum function-related salary levels in 2003 have been increased by less than 1% on average compared with those of 2002. In 2003, the (maximum) function-related salary of the President/CEO was EUR 1,020,000 and that of the Vice-Chairman/CFO EUR 840,000; the (maximum) function-related salary of the other Board members was EUR 660,000. The annual review date for the base salary is 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 114 of the separate booklet entitled 'Financial Statements and Analysis'.

For 2004, only limited adjustment with respect to the salary levels is expected.

### Annual Incentive (bonus)

Each year, a variable cash incentive (Annual Incentive) can be earned, based on factors such as the achievement of specific targets. These targets are set at a challenging level, taking into account general trends in the relevant markets, and are partly (70%) linked to the financial results of the Philips Group and partly (30%) to the set team targets based on the areas of responsibility monitored by the individual members of the Board of Management. The Annual Incentive criteria are 1) the financial indicators of the Company: net income and cash flow, and 2) team targets. 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. The financial targets, based on US GAAP financial measures, pursue value creation as the main business objective.

The on-target Annual Incentive percentage is set at 60% of base salary, and the maximum Annual Incentive achievable is 90% of the annual base salary. In exceptional circumstances, the Remuneration Committee may decide to increase this percentage by 20% (resulting in an Annual Incentive percentage of 108%). The Annual Incentive pay-out in any year relates to the achievements of the preceding financial year versus agreed targets. As a result, Annual Incentives paid in 2003 relate to the salary levels and the performance in the year 2002. Similarly, the Annual Incentive payable in 2004 will be calculated on the basis of the 2003 annual results.

The 2002 results led to an Annual Incentive pay-out in 2003, based on the degree of achievement of the financial targets and team targets for 2002. This pay-out and the pay-out in the previous two years are shown in the table below.

Members Board of Management <sup>1)</sup>	Pay-out in 2001		Pay-out in 2002		Pay-out in 2003	
	realized Annual Incentive	as a % of base salary (2000)	realized Annual Incentive	as a % of base salary (2001)	realized Annual Incentive	as a % of base salary (2002)
G.J. Kleisterlee	248,520 <sup>2)</sup>	62,0%	0	0%	229,640	27.8%
J.H.M. Hommen	370,625	60.5%	0	0%	187,213	27.8%
G.H.A. Dutiné <sup>3)</sup>	n.a. <sup>4)</sup>	n.a. <sup>4)</sup>	n.a. <sup>4)</sup>	n.a. <sup>4)</sup>	158,000	42.1%
A. Huijser <sup>3)</sup>	n.a. <sup>4)</sup>	n.a. <sup>4)</sup>	n.a. <sup>4)</sup>	n.a. <sup>4)</sup>	93,944	27.8%

1) Reference date for Board membership is December 31, 2003

2) Related to period April – December 2000

3) Related to period April – December 2002

4) Not applicable due to the fact that the respective member was not a member of the Board of Management at that time

For 2004 the weight of the financial targets (70%) and the set team targets (30%) will be changed to 80% financial targets and 20% team targets.

### Long-Term Incentive Plan (LTIP)

For many years Philips has operated a long-term incentive plan, which has served to align the interests of the participating employees with the shareholders' interests and to attract, motivate and retain participating employees. Until 2002 the long-term incentive awards consisted exclusively of stock options, but several developments led to a search for alternatives.

In view of the extreme volatility of stock markets in recent years, which could lead to undesirable reward consequences for grantees, and the considerable future share overhang which could result from continuation of the old stock option plan, a long-term incentive plan has been designed consisting of a mix of restricted shares and stock options. Against the background of the continuous endeavors to improve our corporate governance Philips requested and obtained shareholder approval for this Long-Term Incentive Plan at the General Meeting of Shareholders in 2003.

For grantees, this Long-Term Incentive Plan results in less volatility in their income. For the Company the plan will reduce the impact of future share overhang, because restricted shares will partly replace the original number of stock options in each grant (1 restricted share for 3 stock options).

By granting additional (premium) shares after the grantees have held the restricted shares for 3 years after delivery, provided they are still in service, grantees will be more stimulated to focus on the longer term as shareholders of the Company. This is considered important to the success of our efforts to become world-class.

In 2003 stock options remained a part of the Long-Term Incentive Plan as the labor market trend towards more extensive use of restricted shares is at an early stage. Philips, as one of the first employers to introduce restricted shares on such a wide scale, will continue to monitor closely the trend towards employee long-term incentive plans during the coming period to secure its position in the labor market.

The actual number of long-term incentives that will be granted to the members of the Board of Management, the other members of the Group Management Committee, Executives and other key employees depends on the team and/or individual performance of the team/individual and on the share performance of Philips.

The share performance of Philips is measured on the basis of the Philips Total Shareholder Return (TSR) compared to the TSR of a peer group of 24 leading multinational electronics/electrical equipment companies over a three-year period<sup>1</sup>. The TSR performance of Philips and the companies in the peer group is divided into quintiles. Based on this relative TSR position at the end of December, the Supervisory Board establishes a multiplier which varies from 0.8 – 1.2 and depends on the quintile in which the Philips TSR result falls. For 2003 the Supervisory Board has applied a multiplier of 1.1, based on the Philips share performance over the period from the last working day in December 1999 to December 31, 2002. Based on this multiplier, the General Meeting of Shareholders approved a pool of 12 million stock options and 4 million restricted shares (based on a multiplier of 1.1, but excluding premium shares).

Every individual grant, the size of which depends on the positions (often job grade) and performance of the individuals, will be multiplied by the outcome of the multiplier.

In 2003, 7,522,845 stock options and 2,463,512 restricted shares were granted under the LTIP (excluding the premium shares to be delivered after a three-year holding period) (in 2002 some 22 million stock options were granted).

This LTIP will be continued in 2004 and onwards. If substantial changes are to be made, Philips will again seek shareholder approval.

#### Grants to members of the Board of Management under the Long-Term Incentive Plan

	2001 <sup>2)</sup>	2002 <sup>1)</sup>		2003
Members Board of Management	stock options	stock options	restricted share rights	stock options
G.J. Kleisterlee	105,000	115,200	17,601	52,803
J.H.M. Hommen	70,000	96,000	14,667	44,001
G.H.A. Duti�n�	n.a.	124,800 <sup>3)4)</sup>	11,736	35,208
A. Huijser	35,000 <sup>4)</sup>	76,800	11,736	35,208

1) Stock Option Performance Factor of 1.2 applied

2) Taking into account that 75% of the 2001 performance-related stock options will be eligible for vesting in 2004

3) Including sign-on stock option grant

4) Awarded before date of appointment as member of Board of Management

For more details of the Long-Term Incentive Plan, see pages 109 - 113 of the separate booklet entitled 'Financial Statements and Analysis'.

In 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 that 75% of the performance-related stock options granted in 2001 will vest given Philips' performance

I Electrolux, Emerson Electric, Ericsson, General Electric, Gillette, Hitachi, IBM, Intel, LG Electronics, Lucent, Marconi, Matsushita, Motorola, NEC, Nokia, Philips, Samsung, Sanyo Electric, Sharp, Siemens, Sony, Texas Instruments, Tyco International, Whirlpool

vis-à-vis the defined peer group (positioned in the second-top quintile of the list) during the observation period November 30, 2000 to November 30, 2003, as stated in the terms & conditions of the 2001 plan.

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).

The Long-Term Incentive Plan will essentially remain the same in 2004. To further align the interests of the members of the Board of Management and shareholders, restricted shares granted to these Board members shall be retained for a period of at least five years or until at least the end of employment, if this period is shorter. To further align the interests of other Philips Senior Executives and shareholders, compulsory share ownership for those individuals will be introduced in 2004.

A proposal to allocate a maximum of 2.5% of the annual LTIP pool-size to members of the Board of Management will be submitted to the 2004 General Meeting of Shareholders.

### Pensions

The final-pay pensions of members of the Board of Management are funded by the Stichting Philips Pensioenfonds (the 'Philips Pension Fund') of the Netherlands. The conditions contained in the by-laws and the regulations 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 contract of employment 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 and regulations. 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 63,024 and 6% of the difference between the gross pensionable salary minus the franchise and the above-mentioned amount of EUR 63,024. A different arrangement resulting in additional pension benefits may apply in some cases as a result of past policies.

A review of the Dutch Executive pension plan, including Board of Management members and other Group Management Committee members, has been scheduled for 2004.

### Additional arrangements

In addition to the main conditions of employment, a number of additional arrangements apply to members of the Board of Management. These additional arrangements, such as expense and relocation allowances, medical insurance, accident insurance and company car arrangements, are broadly in line with those for Philips Executives in the Netherlands. In the event of disablement, members of the Board of Management are entitled to benefits in line with those for other Philips Executives in the Netherlands. They also benefit from coverage under the Company's Directors and Officers (D&O) policies.

The Company's policy forbids personal loans to members of the Board of Management, and no loans have been granted to such members in 2003, nor are such loans outstanding as of December 31, 2003.

### Contracts of employment

Members of the Board of Management have a contract of employment with the Company. The form of contract used for members of the Board of Management is in line with the standard form used for other Philips Executives. As from August 1, 2003 for newly appointed members of the Board of Management and the other members of the Group Management Committee the term of the contract is set at 4 years; if the Company terminates the contract of employment the maximum severance payment is in principle limited to one year of base salary in line with the Dutch Corporate Governance Code issued on December 9, 2003.

The contract terms for current members of the Board of Management are presented in the table below.

Members Board of Management <sup>1)</sup>	end of term
G.J. Kleisterlee	May 1, 2005
J.H.M. Hommen	May 1, 2005
G.H.A. Dutiné	April 1, 2007
A. Huijser	April 1, 2006

1) Reference date for Board membership is December 31, 2003

The maximum remuneration in the event of dismissal is one year's base salary. If the maximum of one year's salary would be manifestly unreasonable for a Board member who is dismissed during his first term of office, the Board member shall be eligible for a severance payment not exceeding twice the annual salary.

### Report of the Audit Committee

The Audit Committee, currently consisting of three members of the Supervisory Board, assists the Supervisory Board in fulfilling its supervisory responsibilities for the integrity of the Company's financial statements, the financial reporting process, the system of internal business controls and risk management, the internal and external audit process, the internal and external auditor's qualifications, independence and performance, as well as the Company's process for monitoring compliance with laws and regulations and the General Business Principles. The Audit Committee met five times in 2003 and reported its findings periodically to the plenary Supervisory Board.

In accordance with its charter, which is part of the Rules of Procedure of the Supervisory Board, the Audit Committee in 2003 reviewed the Company's annual and interim financial statements, including non-financial information, prior to publication thereof. It also assessed in its quarterly meetings the adequacy and appropriateness of internal control policies and internal audit programs and their findings. In its 2003 meetings, the Audit Committee periodically reviewed 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 were examined thoroughly in order to allow appropriate measures to be taken. With regard to the internal audit, the Audit Committee reviewed 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 reviewed the proposed audit scope, approach and fees (refer to page 43 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 considered the report of the external auditors with respect to the annual financial statements and advised on the Supervisory Board's statement to shareholders in the annual accounts.

In 2003 the Audit Committee periodically discussed 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. It also discussed overviews on tax, IT, environmental exposures, financial exposures in the area of treasury, real estate and pensions. The Company's internal and external auditors attended all Committee meetings in 2003, and the Committee met separately after each meeting with the President/Chief Executive Officer, the Chief Financial Officer, the internal auditor and the external auditors.

#### 2003 financial statements

The financial statements of Koninklijke Philips Electronics N.V. for 2003, as presented by the Board of Management, have been audited by KPMG Accountants N.V., independent auditors. Their report appears on page 145 of the separate booklet entitled 'Financial Statements and Analysis'. We have approved these financial statements, and all individual members of the Supervisory Board (together with the members of the Board of Management) have signed these documents.

We recommend to shareholders that they adopt the 2003 financial statements as presented in the full Annual Report for the year 2003. We likewise recommend to shareholders that they adopt the proposal of the Board of Management to pay a dividend of EUR 0.36 per common share.

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

February 6, 2004

*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 2003 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, 2003 and 2002, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2003 (not presented separately herein); and in our report dated February 6, 2004, 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 76 to 79, is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

Eindhoven, February 6, 2004

*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'). Historical cost is used as the measurement basis unless otherwise indicated.

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

in millions of euros unless otherwise stated

	2002	2003
Sales	31,820	29,037
Cost of sales	(21,722)	(19,558)
<b>Gross margin</b>	<u>10,098</u>	<u>9,479</u>
Selling expenses	(5,201)	(4,575)
General and administrative expenses	(1,404)	(1,492)
Research and development expenses	(3,043)	(2,617)
Write-off of acquired in-process R&D	(12)	–
Impairment of goodwill	(19)	(148)
Restructuring and impairment charges	(484)	(407)
Other business income (expense)	485	248
<b>Income from operations</b>	<u>420</u>	<u>488</u>
Financial income and expenses	(2,227)	(244)
<b>Income (loss) before taxes</b>	<u>(1,807)</u>	<u>244</u>
Income tax (expense) benefit	(27)	15
<b>Income (loss) after taxes</b>	<u>(1,834)</u>	<u>259</u>
Results relating to unconsolidated companies	(1,346)	506
Minority interests	(26)	(56)
<b>Income (loss) before cumulative effect of a change in accounting principles</b>	<u>(3,206)</u>	<u>709</u>
Cumulative effect of a change in accounting principles, net of tax	–	(14)
<b>Net income (loss)</b>	<u>(3,206)</u>	<u>695</u>
Weighted average number of common shares outstanding (after deduction of treasury stock), during the year (in thousands)	1,274,950	1,277,174
<b>Basic earnings per common share in euros:</b>		
Income (loss) before cumulative effect of a change in accounting principles	(2.51)	0.55
Net income (loss)	(2.51)	0.54
<b>Diluted earnings per common share in euros *:</b>		
Income (loss) before cumulative effect of a change in accounting principles	(2.51)	0.55
Net income (loss)	(2.51)	0.54
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.

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

in millions of euros

	2002	2003
<b>Current assets</b>		
Cash and cash equivalents	1,858	3,072
Receivables	5,068	4,628
Inventories	3,522	3,204
Other current assets	<u>603</u>	<u>599</u>
<b>Total current assets</b>	<b>11,051</b>	<b>11,503</b>
<b>Non-current assets</b>		
Investments in unconsolidated companies	6,089	4,841
Other non-current financial assets	1,306	1,213
Non-current receivables	219	218
Other non-current assets	2,553	2,581
Property, plant and equipment – net	6,137	4,879
Intangible assets excl. goodwill – net	1,742	1,271
Goodwill	<u>3,192</u>	<u>2,494</u>
<b>Total non-current assets</b>	<b><u>21,238</u></b>	<b><u>17,497</u></b>
<b>Total</b>	<b>32,289</b>	<b>29,000</b>
<b>Current liabilities</b>		
Accounts and notes payable	3,228	3,205
Accrued liabilities	3,314	2,754
Short-term provisions	1,276	949
Other current liabilities	691	649
Short-term debt	<u>617</u>	<u>1,684</u>
<b>Total current liabilities</b>	<b>9,126</b>	<b>9,241</b>
<b>Non-current liabilities</b>		
Long-term debt	6,492	4,192
Long-term provisions	1,970	1,976
Other non-current liabilities	<u>603</u>	<u>653</u>
<b>Total non-current liabilities</b>	<b>9,065</b>	<b>6,821</b>
Minority interests	179	175
Stockholders' equity	<u>13,919</u>	<u>12,763</u>
<b>Total</b>	<b>32,289</b>	<b>29,000</b>

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

in millions of euros

	2002	2003
<b>Cash flows from operating activities:</b>		
Net income (loss)	(3,206)	695
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,184	2,015
Impairment of equity investments	3,260	772
Net gain on sale of assets	(643)	(987)
Loss (income) from unconsolidated companies (net of dividends received)	54	(569)
Minority interests (net of dividends paid)	26	49
Decrease in working capital/other current assets	815	307
Decrease (increase) in non-current receivables/other assets	86	(243)
Decrease in provisions	(336)	(155)
Other items	(12)	108
<b>Net cash provided by operating activities</b>	<b>2,228</b>	<b>1,992</b>
<b>Cash flows from investing activities:</b>		
Purchase of intangible assets	(149)	(96)
Capital expenditures on property, plant and equipment	(1,161)	(980)
Proceeds from disposals of property, plant and equipment	370	220
Cash from derivatives	422	391
Purchase of other non-current financial assets	(15)	(18)
Proceeds from other non-current financial assets	98	323
Purchase of businesses – net of cash acquired	(626)	(470)
Proceeds from sale of interests in businesses	813	1,372
<b>Net cash (used for) provided by investing activities</b>	<b>(248)</b>	<b>742</b>
<b>Cash flows before financing activities</b>	<b>1,980</b>	<b>2,734</b>
<b>Cash flows from financing activities:</b>		
(Decrease) increase in short-term debt	(548)	49
Principal payments on long-term debt	(276)	(1,304)
Proceeds from issuance of long-term debt	405	311
Treasury stock transactions	(19)	49
Dividends paid	(459)	(460)
<b>Net cash used for financing activities</b>	<b>(897)</b>	<b>(1,355)</b>
<b>Cash provided by continuing operations</b>	<b>1,083</b>	<b>1,379</b>
Effect of changes in exchange rates on cash positions	(115)	(165)
Cash and cash equivalents at beginning of year	890	1,858
<b>Cash and cash equivalents at end of year</b>	<b>1,858</b>	<b>3,072</b>

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

in millions of euros unless otherwise stated

	Outstanding number of shares in thousands	Accumulated other comprehensive income (loss)									Total stockholders' equity
		Common stock	Capital in excess of par value	Retained earnings	Currency translation differences	Unrealized gain (loss) on available for sale securities	Additional minimum pension liability	Change in fair value of cash flow hedges	Total	Treasury shares at cost	
<b>Balance as of December 31, 2001</b>	1,274,172	263	13	20,403	(766)	566	(18)	(7)	(225)	(1,294)	19,160
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				(3,206)	(946)	(301)	(335)	18	(1,564)		(4,770)
Dividend paid				(459)							(459)
Purchase of treasury stock	(3,128)									(103)	(103)
Re-issuance of treasury stock	4,934									90	90
Stock options accrual			1								1
<b>Balance as of December 31, 2002</b>	1,275,978	263	14	16,738	(1,712)	265	(353)	11	(1,789)	(1,307)	13,919
Net income (loss)				695							695
Net current period change					(1,680)	297	(9)	7	(1,385)		(1,385)
Reclassifications into income					28	(146)		7	(111)		(111)
Total comprehensive income (loss), net of tax				695	(1,652)	151	(9)	14	(1,496)		(801)
Dividend paid				(463)							(463)
Purchase of treasury stock	(44)									(1)	(1)
Re-issuance of treasury stock	4,752		12							52	64
Stock options: compensation plans			45								45
<b>Balance as of December 31, 2003</b>	1,280,686	263	71	16,970	(3,364)	416	(362)	25	(3,285)	(1,256)	12,763

# The Philips Group in the last ten 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

	Dutch GAAP						US GAAP				
	1994	1995	1996	1997	1998*	1998*	1999	2000	2001	2002	2003
Sales	23,768	25,259	27,094	29,658	30,459	30,459	31,459	37,862	32,339	31,820	29,037
Percentage increase over previous year	2	6	7	9	3	3	3	20	(15)	(2)	(9)
Income (loss) from continuing operations <sup>1)</sup>	683	971	126	1,231	541	1,025	1,595	9,577	(2,475)	(3,206)	709
Discontinued operations <sup>2)</sup>	281	247	202	263	5,054	4,891	–	–	–	–	–
Cumulative effect of change in accounting principles	–	–	–	–	–	–	–	85	–	–	(14)
Net income (loss)	964	1,143	(268)	2,602	6,053	5,900	1,590	9,662	(2,475)	(3,206)	695
Turnover rate of net operating capital	2.95	2.88	2.70	2.84	2.91	2.95	3.20	3.12	2.15	2.43	2.99
Total employees at year-end (in thousands)	241	253	250	252	234	234	227	219	189	170	164
Salaries, wages and social costs paid	7,031	7,363	8,083	8,261	8,209	8,117	8,111	8,479	8,119	8,183	7,451

## Income

Income (loss) from operations	1,227	1,350	422	1,714	685	1,289	1,553	4,258	(1,395)	420	488
As a % of sales	5.2	5.3	1.6	5.8	2.2	4.2	4.9	11.2	(4.3)	1.3	1.7
Income taxes	(135)	(74)	7	(276)	(41)	(162)	(208)	(563)	428	(27)	15
As a % of income before taxes	16	7	(40)	20	11	17	14	9	19	(1)	(6)
Income (loss) after taxes	696	964	25	1,119	332	816	1,238	5,688	(1,882)	(1,834)	259
As a % of sales	2.9	3.8	0.1	3.8	1.1	2.7	3.9	15.0	(5.8)	(5.8)	0.9
Income (loss) before cumulative effect of change in accounting principles	683	971	126	1,231	541	1,025	1,595	9,577	(2,475)	(3,206)	709
As a % of stockholders' equity (ROE)	12.5	15.8	1.9	15.9	5.1	9.7	10.9	48.5	(11.9)	(19.2)	5.4
Per common share in euros	0.51	0.71	0.09	0.88	0.38	0.71	1.16	7.30	(1.94)	(2.51)	0.55
Net income (loss)	964	1,143	(268)	2,602	6,053	5,900	1,590	9,662	(2,475)	(3,206)	695
Per common share in euros	0.72	0.84	(0.20)	1.86	4.20	4.10	1.15	7.36	(1.94)	(2.51)	0.54
Dividend paid per common share in euros	0.06	0.14	0.18	0.18	0.23	0.23	0.25	0.30	0.36	0.36	0.36

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

	Dutch GAAP										US GAAP
	1994	1995	1996	1997	1998*	1998*	1999	2000	2001	2002	2003
Cash and cash equivalents	940	932	785	1,397	6,553	6,553	2,331	1,089	890	1,858	3,072
Receivables	4,567	4,890	5,369	5,464	5,442	5,442	6,453	6,806	6,670	5,671	5,227
Inventories	4,330	5,083	4,334	4,522	4,274	4,017	4,268	5,279	4,290	3,522	3,204
<b>Current assets</b>	<b>9,837</b>	<b>10,905</b>	<b>10,488</b>	<b>11,383</b>	<b>16,269</b>	<b>16,012</b>	<b>13,052</b>	<b>13,174</b>	<b>11,850</b>	<b>11,051</b>	<b>11,503</b>
Non-current financial assets/unconsolidated companies	1,257	1,358	1,618	1,451	2,836	2,871	7,400	11,306	11,033	7,395	6,054
Net assets discontinued operations	901	1,013	1,198	1,482	–	–	–	–	–	–	–
Non-current receivables	1,397	1,413	1,662	1,858	1,920	1,920	2,326	2,713	3,080	2,772	2,799
Property, plant and equipment (book value)	5,599	6,094	6,719	6,935	6,574	6,597	7,332	9,041	7,718	6,137	4,879
Intangible assets (book value)	105	198	222	213	554	609	1,563	3,290	5,521	4,934	3,765
<b>Non-current assets</b>	<b>9,259</b>	<b>10,076</b>	<b>11,419</b>	<b>11,939</b>	<b>11,884</b>	<b>11,997</b>	<b>18,621</b>	<b>26,350</b>	<b>27,352</b>	<b>21,238</b>	<b>17,497</b>
<b>Total assets</b>	<b>19,096</b>	<b>20,981</b>	<b>21,907</b>	<b>23,322</b>	<b>28,153</b>	<b>28,009</b>	<b>31,673</b>	<b>39,524</b>	<b>39,202</b>	<b>32,289</b>	<b>29,000</b>
Property, plant and equipment:											
Capital expenditures for the year	1,535	2,127	2,185	1,627	1,634	1,634	1,662	3,170	2,143	1,161	980
Depreciation for the year	1,270	1,218	1,437	1,492	1,615	1,615	1,548	1,789	1,969	1,782	1,519
Capital expenditures : depreciation	1.2	1.7	1.5	1.1	1.0	1.0	1.1	1.8	1.1	0.7	0.6
Inventories as a % of sales	18.2	20.1	16.0	15.2	14.0	13.2	13.6	13.9	13.3	11.1	11.0
Outstanding trade receivables, in months' sales	1.5	1.5	1.3	1.3	1.3	1.3	1.4	1.5	1.5	1.3	1.4

## Financial structure

Other liabilities	5,373	5,643	5,768	6,328	6,779	6,751	8,262	8,764	8,234	7,836	7,261
Debt	3,875	4,756	5,855	4,030	3,587	3,587	3,314	4,027	7,866	7,109	5,876
Provisions	3,566	3,460	3,420	3,251	2,985	2,973	3,056	3,557	3,740	3,246	2,925
<b>Total provisions and liabilities</b>	<b>12,814</b>	<b>13,859</b>	<b>15,043</b>	<b>13,609</b>	<b>13,351</b>	<b>13,311</b>	<b>14,632</b>	<b>16,348</b>	<b>19,840</b>	<b>18,191</b>	<b>16,062</b>
Minority interests	336	496	279	559	242	242	333	469	202	179	175
Issued, paid-up capital	1,536	1,566	1,600	1,655	1,672	1,672	339	263	263	263	263
Surplus and reserves	4,410	5,060	4,985	7,499	12,888	12,784	16,369	22,444	18,897	13,656	12,500
<b>Stockholders' equity</b>	<b>5,946</b>	<b>6,626</b>	<b>6,585</b>	<b>9,154</b>	<b>14,560</b>	<b>14,456</b>	<b>16,708</b>	<b>22,707</b>	<b>19,160</b>	<b>13,919</b>	<b>12,763</b>
<b>Total equity and liabilities</b>	<b>19,096</b>	<b>20,981</b>	<b>21,907</b>	<b>23,322</b>	<b>28,153</b>	<b>28,009</b>	<b>31,673</b>	<b>39,524</b>	<b>39,202</b>	<b>32,289</b>	<b>29,000</b>
Net debt : group equity ratio	32:68	35:65	42:58	21:79	**	**	5:95	11:89	26:74	27:73	18:82
Stockholders' equity per common share in euros	4.41	4.85	4.74	6.39	10.09	10.02	12.55	17.69	15.04	10.91	9.97
Market price per common share at year-end	5.83	6.58	7.94	13.80	14.30	14.30	33.75	39.02	33.38	16.70	23.15

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

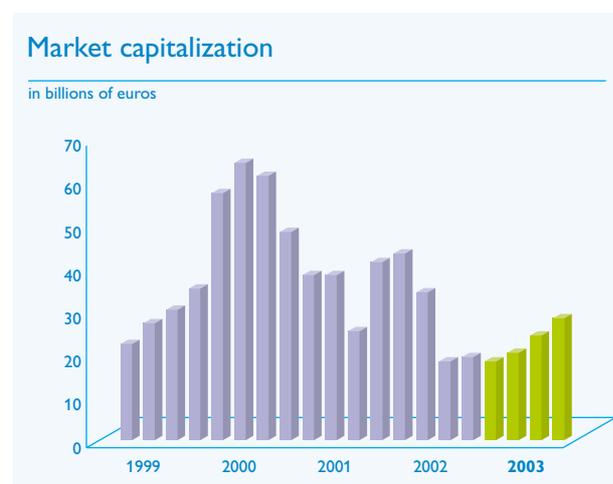
# Shareholder information

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

Shareholders are also welcome to visit our website [www.philips.com](http://www.philips.com), which provides extensive information about the Philips Group.

## Market capitalization

The market capitalization of the Philips shares at year-end 2003 was EUR 29,648 million. The highest trading price for Philips' shares in 2003 was EUR 24.86 on December 4, and the lowest was EUR 12.65 on March 12, both in Amsterdam.



## Listings

Philips' shares are listed on several European stock exchanges and on the New York Stock Exchange.

City	Exchange	Ticker
Amsterdam	Euronext	PHIA
New York	New York Stock Exchange	PHG
Paris <sup>1)</sup>	Euronext	RPE
Frankfurt <sup>2)</sup>	Deutsche Börse	PHI1

1) delisting envisaged as of February 27, 2004  
2) delisting envisaged as of April 8, 2004

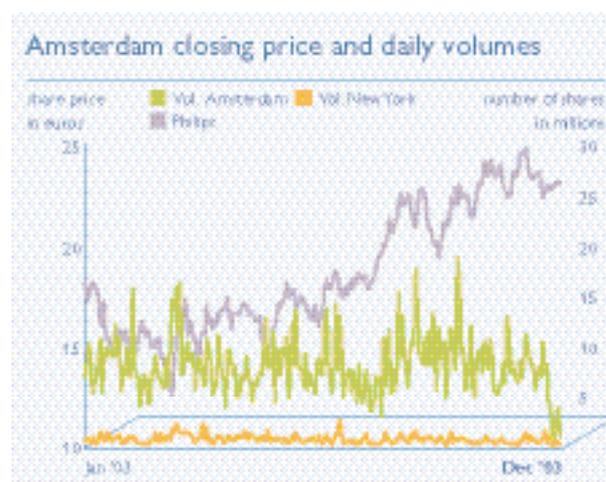
## Share price development and trading volumes

Tables with highs and lows share prices in Amsterdam and New York in 2003:

	J	F	M	A	M	J
Amsterdam						
high	18.25	16.30	17.43	17.45	17.25	18.21
low	14.67	14.46	12.65	14.50	14.75	16.40
New York						
high	19.25	17.35	18.68	19.10	19.72	21.11
low	15.94	15.61	14.26	15.97	17.41	19.06

	J	A	S	O	N	D
Amsterdam						
high	18.83	22.20	22.83	23.19	24.27	24.86
low	16.06	17.93	19.46	20.06	22.43	22.47
New York						
high	21.10	24.40	25.80	27.03	28.42	29.61
low	18.98	20.37	22.83	23.69	26.63	27.79

	2003	Q1	Q2	Q3	Q4
Amsterdam					
high	24.86	18.25	18.21	22.83	24.86
low	12.65	12.65	14.50	16.06	20.06
New York					
high	29.61	19.25	21.11	25.80	29.61
low	14.26	14.26	15.97	18.98	23.69



## Performance in relation to the AEX index



## Dividend policy

Philips aims for a sustainable and stable dividend reflecting, over time, a distribution of 25 to 30% of continuing net income. The dividend paid over the last ten years is shown in the graph below.



Amounts previously reported in Dutch guilders are now reported in euros using the irrevocably fixed conversion rate which became effective on January 1, 1999 (EUR 1 = NLG 2.20371). In addition, the amounts are corrected for the 4:1 stock split in 2000.

## Dividend to shareholders

Shares of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics') will be listed ex-dividend as of March 26, 2004. In compliance with the listing requirements of the New York Stock Exchange and the stock market of Euronext Amsterdam, the record dates will be March 30, 2004 for holders of American shares of New York Registry, and March 25, 2004 for other Philips shares. The dividend as

proposed to the General Meeting of Shareholders will be payable as of April 5, 2004 to all shareholders. The dividend payment to holders of American shares will be made in USD at the USD/EUR rate fixed by the European Central Bank on March 31, 2004.

## Financial calendar

### Annual General Meeting of Shareholders

Record date Annual General Meeting of Shareholders	March 18, 2004
Annual General Meeting of Shareholders	March 25, 2004

### Quarterly reports 2004

First quarterly report	April 13, 2004
Second quarterly report	July 13, 2004
Third quarterly report	October 12, 2004

### Divisional analyst days 2004

Analyst day 1	June 9, 2004 *
Analyst day 2	September 24, 2004 *
Analyst day 3	November 23, 2004 *

### 2005

Publication of 2004 results	February 8, 2005 *
Publication of the Annual Report 2004	February 8, 2005 *
Annual General Meeting of Shareholders	March 31, 2005 *
First quarterly report 2005	April 12, 2005 *
Second quarterly report 2005	July 12, 2005 *
Third quarterly report 2005	October 11, 2005 *

\* These dates are subject to final confirmation.

## Dividend dates

	Ex dividend date	Record date	Payment date
Amsterdam shares	March 26	March 25	April 5
New York shares	March 26	March 30	April 5

## Shareholders' Communications Channel

Philips is continuously striving to improve 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.

# Shareholder information

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 25, 2004 a record date (being March 18, 2004) will apply: those persons who on March 18, 2004 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 in and vote at the Meeting.

## Shareholder services

### In the USA

Holders of shares of New York Registry and other interested parties in the USA can obtain copies of the Annual Report 2003, free of charge, from the Transfer and Register Agent:

Citibank Shareholder Services

P.O. Box 43077

Providence, Rhode Island 02940-3077

Telephone: 1-877-CITI-ADR (toll-free)

Fax: 1-201-324-3284

E-mail: [citibank@shareholders-online.com](mailto:citibank@shareholders-online.com)

Internet address:

[www.citibank.com/adr](http://www.citibank.com/adr)

Communications concerning share transfers, lost certificates, dividends and change of address should be directed to Citibank.

The Annual Report on Form 20-F is filed electronically with the United States Securities and Exchange Commission.

### Outside the USA

Non-US shareholders and other non-US interested parties can obtain copies of the Annual Report 2003 free of charge from:

Royal Philips Electronics

Annual Report Office

P.O. Box 218

5600 MD Eindhoven, The Netherlands

Fax: 31-40-2786436

Communications concerning share transfers, lost certificates, dividends and change of address should be directed to:

ABN AMRO

Afdeling Issuing Institutions

Kemelstede 2

4817 ST Breda, The Netherlands

Telephone: 31-76-5799482

Fax: 31-76-5799359

The Management Report booklet of the Annual Report 2003 is also available in a Dutch translation.

## Information sources

Investors and financial analysts may contact:

Investor Relations

Breitner Center, HBT 11-8

P.O. Box 77900

1070 MX Amsterdam, The Netherlands

Tel: 31-20-59 77221

Fax: 31-20-59 77220

E-mail: [investor.relations@philips.com](mailto:investor.relations@philips.com)

Senior Vice-President – Investor Relations,

Tel: 31-20-59 77222

Manager – Investor Relations,

Tel: 31-20-59 77447



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