

# Balance sheets and additional ratios

all amounts in millions of Dutch guilders unless otherwise stated

## Consolidated balance sheets

	1998 June 30,	1997	
		December 31,	
		pro forma*	historical
Cash and cash equivalents	<b>2,530</b>	3,079	3,773
Receivables	<b>13,262</b>	11,659	16,471
Inventories	<b>11,739</b>	9,966	11,421
Non-current assets	<b>25,316</b>	26,690	27,776
<b>Total assets</b>	<b>52,847</b>	51,394	59,441
Total current liabilities	<b>17,990</b>	18,535	23,986
Long-term debt	<b>6,634</b>	7,072	7,323
Long-term provisions	<b>5,333</b>	5,098	6,275
<b>Group equity</b>	<b>22,890</b>	20,689	21,857
Of which stockholders' equity	<b>21,618</b>	19,457	19,457
<i>Per common share in NLG:</i>	<b>60.11</b>	54.36	54.36

\* The pro forma 1997 amounts reflect the balance sheet including PolyGram on an unconsolidated basis.

## Number of common shares outstanding

	1998 June 30,	1997
Shares in thousands (on 31.12.1997 : 364,777)	<b>366,034</b>	353,952

## Number of employees

Comparable figure on 1.1.1998 : 252,100	<b>254,900</b>	266,300
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## Ratios

Net debt : group equity ratio (at year-end 1997 21:79)	<b>21:79</b>	39:61
Inventories as a % of sales	<b>14.9</b>	18.5
Outstanding trade receivables, in months' sales	<b>1.5</b>	1.7

	January to June	
Income from operations:		
As a % of sales	<b>5.1</b>	6.0
As a % of net operating capital (RONA)	<b>14.8</b>	15.7
Income from normal business operations		
as a % of stockholders' equity (ROE)	<b>17.7</b>	16.1

## Product sectors

all amounts in millions of Dutch guilders unless otherwise stated

### Sales and total assets

	sales (to third parties)			total assets	
	January to June 1998			1998	1997
	amount	% growth		June 30,	December 31,
		nominal	comparable *		
Lighting	4,840	2	2	6,124	6,001
Consumer Products	12,691	21	11	11,601	11,205
Components	4,109	13	11	7,458	6,932
Semiconductors	3,668	16	16	7,322	6,911
Professional	4,463	7	11	4,923	4,823
Origin	1,104	32	27	1,298	1,085
Miscellaneous	1,078	(41)	11	2,715	2,419
Unallocated				8,348	8,723
<b>Total excl. PolyGram</b>	<b>31,953</b>	<b>11</b>	<b>11</b>	<b>49,789</b>	<b>48,099</b>
<b>PolyGram</b>	<b>3,802</b>	<b>(16)</b>	<b>(3)</b>	<b>3,058</b>	<b>11,342</b>
<b>Total</b>	<b>35,755</b>	<b>7</b>	<b>9</b>	<b>52,847</b>	<b>59,441</b>

\* Adjusted for the effects of changes in consolidations and exchange rate movements

### Segment revenues and income from operations

	January to June					
	1998			1997*		
	segment revenues	income (loss) from operations	as % of segment revenues	segment revenues	income (loss) from operations	as % of segment revenues
Lighting	4,892	695	14.2	4,795	580	12.1
Consumer Products	13,020	7	0.1	11,156	214	1.9
Components	5,620	272	4.8	5,090	311	6.1
Semiconductors	4,478	1,003	22.4	3,791	748	19.7
Professional	4,589	181	3.9	4,320	94	2.2
Origin	1,647	48	2.9	1,333	13	1.0
Miscellaneous	1,298	(25)	(1.9)	2,251	(12)	(0.5)
Unallocated		(330)			(380)	
<b>Total excl. PolyGram</b>	<b>35,544</b>	<b>1,851</b>		<b>32,736</b>	<b>1,568</b>	
<b>PolyGram</b>	<b>3,802</b>	<b>(14)</b>	<b>(0.4)</b>	<b>4,526</b>	<b>422</b>	<b>9.3</b>
<b>Total</b>	<b>39,346</b>	<b>1,837</b>		<b>37,262</b>	<b>1,990</b>	
<b>Intersegment sales</b>	<b>(3,591)</b>			<b>(3,876)</b>		
<b>Sales</b>	<b>35,755</b>			<b>33,386</b>		
Income from operations						
as a % of sales						
- excl. PolyGram		5.8			5.4	
- incl. PolyGram		5.1			6.0	

\* Reclassified for reason of comparison

# Main countries and geographic areas

all amounts in millions of Dutch guilders unless otherwise stated

## Sales and fixed assets

	sales (to third parties)		(in) tangible fixed assets		
	January to June 1998		1998	1997	
	amount	% growth nominal-comparable*	June 30,	December 31,	
Netherlands	1,746	19	28	3,587	3,720
United States	7,398	31	10	2,157	2,296
Germany	2,914	-	8	1,703	1,546
France	2,138	-	12	1,031	1,121
United Kingdom	1,837	6	5	763	747
Other countries	15,920	6	10	6,679	6,321
<b>Total excl. PolyGram</b>	<b>31,953</b>	<b>11</b>	<b>11</b>	<b>15,920</b>	<b>15,751</b>
PolyGram	3,802	(16)	(3)	-	3,922
<b>Total</b>	<b>35,755</b>	<b>7</b>	<b>9</b>	<b>15,920</b>	<b>19,673</b>

\* Adjusted for the effects of changes in consolidations and exchange rate movements

## Segment revenues and income from operations

	January to June					
	1998			1997		
	segment revenues	income (loss) from operations	as % of segment revenues	segment revenues	income (loss) from operations	as % of segment revenues
Europe	29,647	1,583	5.3	26,445	915	3.5
USA and Canada	8,594	(220)	(2.6)	6,930	(48)	(0.7)
Latin America	2,522	(27)	(1.1)	2,150	74	3.4
Asia Pacific	11,155	515	4.6	11,415	629	5.5
Africa	133	-	-	107	(2)	(1.9)
<b>Total excl. PolyGram</b>	<b>52,051</b>	<b>1,851</b>		<b>47,047</b>	<b>1,568</b>	
PolyGram	3,802	(14)	(0.4)	4,526	422	9.3
<b>Total</b>	<b>55,853</b>	<b>1,837</b>		<b>51,573</b>	<b>1,990</b>	
Interregional sales	(20,098)			(18,187)		
<b>Sales</b>	<b>35,755</b>			<b>33,386</b>		

### Income from operations

as a % of sales

- excl. PolyGram	5.8	5.4
- incl. PolyGram	5.1	6.0

### 'Safe Harbor' Statement under the Private Securities Litigation Reform Act of October 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. 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, the levels of marketing and promotional expenditures by Philips and its competitors, raw materials and employee costs, changes in future exchange and interest rates, changes in tax rates and future business combinations, acquisitions or dispositions, and the rate of technical changes.

# Statements of income and cash flows

all amounts in millions of Dutch guilders unless otherwise stated

the data included in this report are unaudited

## Consolidated statements of income

	2nd quarter		January to June	
	1998	1997	1998*	1997
Sales	<b>17,919</b>	17,250	<b>35,755</b>	33,386
Income from operations	<b>978</b>	1,154	<b>1,837</b>	1,990
Financial income and expenses	<b>(141)</b>	(224)	<b>(284)</b>	(391)
Income before taxes	<b>837</b>	930	<b>1,553</b>	1,599
Income taxes	<b>(192)</b>	(233)	<b>(357)</b>	(400)
Income after taxes	<b>645</b>	697	<b>1,196</b>	1,199
Results relating to unconsolidated companies	<b>91</b>	54	<b>155</b>	44
Share of other group equity in group income	<b>118</b>	(58)	<b>219</b>	(90)
Income from normal business operations	<b>854</b>	693	<b>1,570</b>	1,153
Extraordinary items - net	<b>179</b>	54	<b>1,024</b>	481
<b>Net income</b>	<b>1,033</b>	747	<b>2,594</b>	1,634

Basic earnings per common share in NLG:

- income from normal business operations	<b>2.37</b>	1.99	<b>4.37</b>	3.31
- net income	<b>2.86</b>	2.14	<b>7.22</b>	4.69

## Consolidated statements of cash flows\*\*

	2nd quarter		January to June	
	1998	1997	1998*	1997
Cash flows from operating activities:				
Net income	<b>1,033</b>	747	<b>2,594</b>	1,634
Depreciation and amortization	<b>870</b>	936	<b>1,746</b>	1,773
Net gain on sale of investments	<b>(392)</b>	(233)	<b>(1,446)</b>	(741)
Increase in working capital	<b>(1,296)</b>	(1,055)	<b>(1,662)</b>	(1,588)
(Decrease) increase in provisions	<b>(190)</b>	(275)	<b>(100)</b>	52
Other adjustments	<b>(155)</b>	157	<b>(282)</b>	309
Net cash generated by operating activities	<b>(130)</b>	277	<b>850</b>	1,439
Cash required for investments	<b>(978)</b>	(1,102)	<b>(2,227)</b>	(2,149)
Proceeds from divestments	<b>343</b>	769	<b>1,519</b>	1,493
<b>Cash flows (before financing activities)</b>	<b>(765)</b>	(56)	<b>142</b>	783

\* The six months period 1998 includes 5 months of PolyGram on a consolidated basis and one month on an unconsolidated basis.

\*\* For a number of reasons, principally the effects of translation differences and consolidation changes, certain items in the statements of cash flows do not correspond to the differences between the balance sheet amounts for the respective items.

## Report on the performance of the Philips Group

*On May 21, 1998 Philips, PolyGram and The Seagram Company Ltd. of Canada announced an agreement in principle on the proposed acquisition of PolyGram by Seagram. Definitive agreements were signed on June 21, 1998. PolyGram has been deconsolidated from the Philips Group accounts as per June, 1998. Consequently, from this date Philips' 75% interest in PolyGram income is reported as Result relating to unconsolidated companies, and Philips' equity interest is included in the balance sheet item Unconsolidated companies. The product sector information for PolyGram in this report therefore includes only the first five months of 1998 compared to six months in 1997. All non-recurring costs in relation to the transaction, incurred either by PolyGram or by Philips, are deferred until closing of the transaction, and these costs will then be matched against the expected extraordinary gain from the divestment. Encouraged by the 'no comment' letter we received from the US anti trust authorities, we expect that the sale of PolyGram to Seagram will be completed during the second half of this year.*

Net income from normal business operations in the first six months amounted to NLG 1,570 million (NLG 4.37 per share), compared to NLG 1,153 million (NLG 3.31 per share) in the corresponding period of 1997.

Extraordinary items contributed NLG 1,024 million to net income in 1998 relating primarily to the sale of Philips Car Systems to Mannesmann VDO and the sale of the Optoelectronics unit to Uniphase Corporation. Last year's NLG 481 million extraordinary gain related largely to the partial flotation of Philips' shareholding in ASM Lithography. Net income thus arrived at NLG 2,594 million versus NLG 1,634 million in the first half of 1997.

Sales in the first half of 1998 were NLG 35,755 million, nominally 7 per cent up on the same period of 1997. Exchange rate fluctuations had a positive effect on sales of 1 per cent. Consolidation changes, of which the most important are the deconsolidations of Car Systems and PolyGram in 1998, and the consolidation of PCC/Lucent in 1997, had a negative effect of 3 per cent. Adjusted for these effects, the comparable sales growth came to 9 per cent.

The first six months of this year were characterized by higher price erosion, amounting to 8 per cent compared to 6 per cent in the same period of last year. The larger part of the increase relates to Consumer Products, in particular Monitors and Consumer Communications, and also to Components, mainly Display Components and Optical Storage.

First-half year income from operations amounted to NLG 1,837 million (5.1 per cent of sales) against NLG 1,990 million (6.0 per cent of sales) in 1997. PolyGram's income from operations in 1998 amounted to a loss of NLG 14 million, representing five months only, compared with a profit of NLG 422 million in the first six months of 1997. Excluding PolyGram, income from operations in 1998 would have been 5.8 per cent of sales compared with 5.4 per cent of sales in 1997. Similarly, the comparable RONA ratio amounts to 16.7 per cent as compared to 14.3 per cent for the corresponding period in 1997. Positive income developments, especially in the Semiconductors, Lighting and Professional sectors were partly offset by the impact of the, as yet, unprofitable Philips Consumer Communications business in the Consumer Products sector, and to a much lesser extent, the consolidation per April 1, 1998, of the joint venture with Hosiden (HAPD) in the Components sector.

Financing costs of NLG 284 million compared favorably to last year's NLG 391 million, due to reduced interest costs on the lower net debt position. The tax burden has been determined at a tentative rate of 23 per cent compared with 25 per cent in the same period of last year. Philips' results relating to unconsolidated companies rose to NLG 155 million from NLG 44 million a year earlier, primarily from the higher contribution of Taiwan Semiconductor Manufacturing Co., despite a downturn in TSMC's second-quarter results, and PolyGram's June net income after tax contribution of NLG 48 million. The share of other group equity in group income swung to a positive contribution of NLG 219 million

from a negative NLG 90 million in 1997, primarily reflecting Lucent's participation in the losses of Philips Consumer Communications, and reduced third party share in PolyGram's lower operating performance (five months in 1998 versus six months in 1997).

### Trend per product sector

*Growth is expressed on a comparable basis*

Sales of the *Lighting* sector increased 2 per cent, in line with market development. Income from operations grew to NLG 695 million from NLG 580 million benefiting from higher margins and improved cost efficiency, as well as from a non-recurring gain relating to the sale of a factory building in Barcelona.

Sales in the *Consumer Products* sector increased by 11 per cent. The most important contribution in Consumer Electronics came from Video and Consumer Communications. Also sales in Digital Video were up significantly. In all business areas sales growth exceeded market development. Domestic Appliances and Personal Care products saw virtually flat sales. Diminishing DAP sales in Asia and Latin America offset significant increases in Europe. Income from operations fell to NLG 7 million from NLG 214 million last year, mainly due to the continuing losses at Consumer Communications, although its results have been showing an improving trend.

The *Components* sector reported 11 per cent higher sales compared to last year, with nearly all businesses contributing. Sales growth exceeded that of the market. Income from operations of NLG 272 million fell below last year's NLG 311 million, partly attributable to the impact of loss-making Hosiden and Philips Display Corporation, Japan. This active matrix liquid crystal displays joint venture was consolidated with effect from April 1, 1998, when Philips acquired an additional 30 per cent of the shares, thus increasing its ownership to 80 per cent. Price erosion and weak market conditions, especially in Display Components, continue to affect income in this sector.

In the *Semiconductors* sector sales grew by 16 per cent, with all businesses and regions contributing. Sales clearly outpaced the total market. Income from operations rose to NLG 1,003 million from NLG 748 million in 1997 due to strong sales, resulting in ongoing high capacity utilization that more than compensated for increased price erosion.

Sales of the *Professional* sector were 11 per cent up on the prior-year period, primarily attributable to Business Electronics. Medical Systems posted modest increases in sales and order intake. Income from operations almost doubled to NLG 181 million from NLG 94 million last year, mainly as a result of the improved performance of most Business Electronics activities.

Sales growth at *Origin* rose sharply at 27 per cent, particularly in Europe. Income from operations of NLG 48 million was up from last year's NLG 13 million, mainly attributable to increased sales and steadily improving operating efficiency.

Sales of the *Miscellaneous* sector grew by 11 per cent, predominantly related to Machinefabrieken. Income from operations fell to a loss of NLG 25 million from a loss of NLG 12 million in the year-earlier period.

*PolyGram* sales were 3 per cent down on last year. The January-June figures for 1998 include only the first five months compared to the full six months in 1997. Income from operations in 1998 further reflects the lack of major international music and film releases in the first half, although June saw an upturn in results compared to the previous months.

## Trend per geographic area

All regions contributed to the sales growth of the group. The most important contribution came from Europe, where strong sales growth continued, particularly in The Netherlands, Germany, France and Eastern Europe. The significant growth in North America was led by Consumer Electronics and the Professional sector. The modest increase in Latin America was the balance of negative growth in the first quarter, being more than offset by positive growth in the second quarter.

The Asia Pacific region posted positive sales growth, although it decelerated during the second quarter. Substantially stronger sales were recorded for Consumer Electronics, Components and Semiconductors, partly offset by lower sales in Domestic Appliances and Personal Care products. Sales in the five Asean countries mostly affected by the financial crisis, were 25 per cent lower in Dutch guilders.

Income from operations in Europe increased sharply, predominantly in Germany, Austria, UK, Belgium and Iberia. Income in North America declined significantly, almost entirely stemming from the first quarter. The negative income from operations is primarily attributable to Philips Consumer Communications. The negative income in Latin America fully originates from Brazil. Argentina and Mexico especially saw income increasing. In Asia Pacific, income from operations fell substantially, mainly during the second quarter, especially in Japan, Singapore, Hong Kong and Taiwan.

## Balance sheet ratios and cash flows

The net debt to group equity ratio at June 30, 1998 arrived at 21:79 compared to 39:61 twelve months earlier. Adjusted for the impact of consolidation changes, mainly PolyGram, and currency fluctuations, inventories at the end of June 1998 came to 17.4 per cent of sales compared to 18.7 per cent a year earlier. Cash flow from operations was NLG 850 million versus NLG 1,439 million last year, the variance being largely attributable to lower income from operations, a higher increase in working capital and a decrease in provisions as opposed to an increase last year. Cash required for investing activities of NLG 708 million was in line with the prior year level of NLG 656 million. Consequently, the resulting cash flow surplus was only NLG 142 million compared with NLG 783 million in the first half of last year.

## Employees

The number of people employed by Philips at the end of June 1998 was 254,900 which reflects an increase of 2,800 employees over the comparable number as at January 1, 1998.

## Outlook

Business performance in the second half of this year will be in part dependant upon how far economic developments in Asia affect the rest of the world. The problems in Asia are more fundamental and longer lasting than was anticipated. Philips' management will continue to focus on those issues which are within its control, such as costs, effectiveness and efficiency of all our processes, productivity, capital expenditure and working capital. In this economic environment our objective as stated in our 1997 annual report to reduce the level of costs by NLG 2.0 billion during this year and next, is even more essential. On the other hand, we stay alert to take advantage of opportunities that present themselves with the objective of creating shareholder value.

We continue to expect to generate double-digit earnings growth, while producing significant positive cash flow in 1998. We stay committed to achieve a 24 per cent RONA over time.

July 23, 1998

Royal Philips Electronics

*Board of Management*