Report on the performance of the Philips Group

Income from normal business operations in the third quarter of 1998 amounted to NLG 449 million (NLG 1.24 per share), down from NLG 721 million (NLG 2.06 per share) in the corresponding quarter in 1997. The reduction in income was partly caused by reduced operating results notably in the sectors Consumer Products, Components and Semiconductors. This is substantially in line with our expectations for the full year 1998 as expressed on September 21, and largely reflects the changed economic environment in certain parts of the world.

For the full nine months income from normal business operations came to NLG 2,019 million (NLG 5.61 per share), ahead of last year's NLG 1,874 million (NLG 5.37 per share). This improvement was realized despite the lower income contribution from PolyGram.
Extraordinary items contributed NLG 1,000 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 1,192 million extraordinary gain related largely to the partial flotation of our shareholdings in ASM Lithography and Taiwan Semiconductor Manufacturing Co. and a loss in connection with the withdrawal from Grundig.
Net income thus arrived at NLG 3,019 million versus NLG 3,066 million in the first nine months of 1997.

Sales in the first nine months of 1998 amounted to NLG 51,881 million, nominally 1 per cent down on the same period of 1997. Currency fluctuations had a net negative effect of less than 1 per cent on sales, whereas consolidation changes had a negative effect of 7 per cent (the most important one being the deconsolidation of PolyGram). Adjusted for these effects, the comparable sales growth came to 7 per cent.
Price erosion has increased during the year to 9 per cent versus 7 per cent in the same period of last year. The larger part of the increase relates to Consumer Products, in particular in Video products and Monitors, although price erosion in Monitors has somewhat eased in the third quarter.

Income from operations in January-September amounted to NLG 2,348 million (4.5 per cent of sales) against NLG 3,164 million (6.1 per cent of sales) in 1997. Excluding PolyGram the income level was 4.9 per cent of sales versus 5.8 per cent of sales in 1997. Similarly, the comparable RONA ratio amounts to 14.2 per cent as compared to 15.7 per cent for the corresponding period in 1997. Adverse income developments in the sectors Consumer Products (especially Consumer Communications and Monitors), Components (notably Display products and the Hosiden and Philips Display Corp. – HAPD Japan losses) and Miscellaneous (discontinued and divested businesses that no longer contribute to income in 1998) were partly offset by the performance improvements in Lighting, Semiconductors, Professional and Origin.

Financing costs of NLG 512 million were better than last year's NLG 555 million. Financial expenses in the third quarter of 1997 included a gain of NLG 128 million, resulting from the sale of shares in two companies. 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.
The results relating to unconsolidated companies including the contribution from PolyGram over the period June-September (NLG 172 million) amounted to NLG 261 million compared to NLG 38 million a year earlier. Excluding PolyGram and a number of incidental items the results remained virtually unchanged. Both Taiwan Semiconductor Manufacturing Co. and ASM Lithography saw slowdowns in results that were largely offset by lower losses from NavTech. The share of other group equity in group income swung to a major positive amount of NLG 344 million from last year's negative amount of NLG 121 million, which predominantly reflected Lucent's share in the losses of Philips Consumer Communications. There were virtually no third-party minority interests in PolyGram's results in 1998.

Trend per product sector

Growth is expressed on a comparable basis

Sales of the *Lighting* sector increased 1 per cent, virtually in line with market growth. Income from operations grew to NLG 977 million from NLG 861 million in 1997, benefiting from higher margins and improved cost efficiency from prior-year restructurings, as well as from a non-recurring gain from the sale of a factory building in Spain.

In the *Consumer Products* sector sales increased by 8 per cent, the main contributions arising from Consumer Communications, Audio/Video and Peripherals, with a significant additional improvement in Digital Video. Sales growth exceeded the market development in all business areas resulting in gains in market shares. The division Domestic Appliances and Personal Care products saw slightly lower sales especially in Domestic Appliances, with sustained growth in Western Europe being more than offset by decreases elsewhere, especially in Asia and Latin America.
Income from operations of the whole sector fell to NLG 96 million from NLG 472 million last year which was primarily due to the sustained losses in Consumer Electronics, notably at Consumer Communications. The Video business realized stronger results but these were offset by lower margins in Monitors and higher costs incurred for improvement projects. DAP reported virtually flat results. License revenues grew, mainly involving optical recording.

The *Components* sector reported 7 per cent higher sales in a shrinking market resulting in higher market shares for its most important businesses. Income from operations of NLG 230 million was significantly below last year's NLG 442 million with the main shortfalls relating to lower income in Display components and Optical Storage both due to severe price erosion, and the losses incurred by HAPD Japan, the active matrix display joint venture that was consolidated with effect from April 1, 1998.

In the *Semiconductors* sector sales grew by 10 per cent, which is remarkable in a market that has decreased by 7 per cent. Practically all businesses and regions contributed to the gain in market share. Income from operations of NLG 1,378 million remained ahead of last year's NLG 1,280 million on account of high capacity utilization and higher license income.

Sales of the *Professional* sector were 9 per cent up on the prior year, primarily attributable to Business Electronics that saw increasing market shares in Fax equipment and Digital Videocommunication Systems. Medical Systems recorded increases in sales and order intake in line with the market. Income from operations of the sector improved to NLG 240 million from NLG 187 million last year, mainly attributable to higher business volume.

Sales growth at *Origin* came to 29 per cent, predominantly realized throughout Europe. Income from operations swung to a profit of NLG 71 million from a loss of NLG 32 million in 1997. Besides strong growth in sales and improving operating efficiency this was also attributable to non-recurring charges in 1997 relating to the discontinuance of the screen phone activities.

The *Miscellaneous* sector saw sales growth of 10 per cent, substantially arising from Machinefabrieken and Plastics and Metalware Factories (PMF). Income from operations decreased from a loss of NLG 18 million in the year-earlier period to a loss of NLG 59 million, primarily due to discontinued and divested businesses no longer contributing to income in 1998.

PolyGram sales were 3 per cent down on last year's. Sales and income for the year to date include only the first five months – prior to deconsolidation – compared to the full nine months in 1997.

Trend per geographic area

As a consequence of sharply lower sales growth in all regions in the third quarter, the growth rate for the full reporting period came to 7 per cent. Europe averaged 11 per cent growth (all sectors and Consumer Products, Components and Semiconductors in particular) with stronger than average growth being realized in The Netherlands. North America performed in line with the Group average and Asia Pacific reported 3 per cent growth, with strong growth in Components and Semiconductors being offset by flat or marginally higher sales in other sectors. In Latin America sales contracted by 4 per cent. Negative growth in Consumer Products and Components was only partly compensated by strong growth in Professional, notably Digital Videocommunication Systems. The dominating negative factor is Brazil for which the stronger other Latin American countries offer only partial compensation.

With the exception of Europe all regions recorded lower income. In Europe, notably in Germany, Austria, Belgium, UK and France income exceeded 1997 levels with the main contributions coming from Semiconductors, Lighting and Business Electronics. North America was particularly affected by the PCC losses. Asia Pacific was also lower due to PCC in addition to lower results from Components (Display Components and HAPD losses) and Semiconductors. The negative income development in Latin America was entirely related to Brazil and was attributable to Consumer Electronics and Components.

Balance sheet ratios and cash flows

The ratio of net debt to group equity at September 30, 1998 was 21:79 compared to 33:67 twelve months earlier. On a substantially comparable basis, i.e. as adjusted for the impact of the deconsolidation of PolyGram and currency fluctuations, inventories at the end of September 1998 came to 18.2 per cent of sales as compared to 19.0 per cent a year earlier. Cash flow from operations was NLG 1,608 million versus NLG 2,617 million last year, the difference mainly relating to PCC and PolyGram. Net cash required for investing activities was NLG 1,471 million whereas in 1997 on balance NLG 28 million cash was generated. The variance lies mainly in the lower proceeds from the divestment of business interests in 1998. Consequently, the resulting cash flow surplus was only NLG 137 million compared with NLG 2,645 million in the corresponding period of last year.

Employees

The number of people employed by the Philips Group at the end of September 1998 was 256,400 reflecting an increase of 5,100 employees over the comparable position as at January 1, 1998. The increase is largely related to Origin, new businesses of Consumer Electronics and Components, the latter mainly representing people that were previously employed under subcontracting arrangements in Hungary.

Outlook

Excluding the results of PolyGram and the charges outlined below, we expect to generate income from normal business operations in 1998 at about the same level as in 1997, when Philips recorded its best year ever.

Subsequent events

The unwinding and subsequent restructuring of PCC, our joint venture with Lucent, together with a planned restructuring of HAPD will result in charges to operating income during the fourth quarter. The amounts involved will be disclosed as soon as they have been defined. In addition, the acquisition of ATL Ultrasound, successfully completed on September 29, will result in a charge of approximately NLG 550 million for in process research and development, and patents and trademarks. The goodwill of NLG 675 million will be amortized over twelve years. ATL will make a positive contribution to income from operations of approximately NLG 50 million in the fourth quarter.

October 22, 1998
Royal Philips Electronics

Board of Management

Balance sheets and additional ratios

all amounts in millions of Dutch guilders unless otherwise stated

Consolidated balance sheets

	1998	1997	
	September 30,	December 31,	
		pro forma*	historical
Cash and cash equivalents	**2,286**	3,079	3,773
Receivables	**12,903**	11,659	16,471
Inventories	**11,970**	9,966	11,421
Non-current assets	**24,620**	26,690	27,776
Total assets	**51,779**	51,394	59,441
Total current liabilities	**18,044**	18,535	23,986
Long-term debt	**6,330**	7,072	7,323
Long-term provisions	**5,152**	5,098	6,275
Group equity	**22,253**	20,689	21,857
Of which stockholders' equity	**21,154**	19,457	19,457
Per common share in NLG	**58.63**	54.36	54.36

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

	1998	1997
	September 30,	

Number of common shares outstanding

Shares in thousands (on 31.12.1997 : 364,777)	**368,495**	354,019

Number of employees

Comparable figure on 1.1.1998 : 251,300	**256,400**	269,900

Ratios

Net debt : group equity ratio (at year-end 1997 21:79)	**21:79**	33:67
Inventories as a % of sales	**15.7**	18.6
Outstanding trade receivables, in months' sales	**1.6**	1.7

	January to September	
Income from operations:		
As a % of sales	**4.5**	6.1
As a % of net operating capital (RONA)	**13.0**	16.3
Income from normal business operations		
as a % of stockholders' equity (ROE)	**14.5**	16.6

Product sectors

all amounts in millions of Dutch guilders unless otherwise stated

Sales and total assets

	sales (to third parties)			total assets	
	January to September 1998			1998	1997
		% growth		September 30,	December 31,
	amount	nominal	comparable*		
Lighting	7,162	(1)	1	5,873	6,001
Consumer Products	19,442	16	8	12,236	11,205
Components	6,160	8	7	7,131	6,932
Semiconductors	5,379	8	10	7,013	6,911
Professional	6,673	3	9	4,880	4,823
Origin	1,704	31	29	1,182	1,085
Miscellaneous	1,559	(42)	10	2,618	2,419
Unallocated				7,841	8,723
Total excl. PolyGram	48,079	7	8	48,774	48,099
PolyGram	3,802	(47)	(3)	3,005	11,342
Total	51,881	(1)	7	51,779	59,441

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

Segment revenues and income from operations

	January to September					
	1998*			1997**		
	segment revenues	income (loss) from operations	as % of segment revenues	segment revenues	income (loss) from operations	as % of segment revenues
Lighting	7,242	977	13.5	7,313	861	11.8
Consumer Products	19,922	96	0.5	17,746	472	2.7
Components	8,498	230	2.7	8,007	442	5.5
Semiconductors	6,638	1,378	20.8	6,033	1,280	21.2
Professional	6,880	240	3.5	6,658	187	2.8
Origin	2,591	71	2.7	2,036	(32)	(1.6)
Miscellaneous	1,872	(59)	(3.2)	3,351	(18)	(0.5)
Unallocated		(571)			(577)	
Total excl. PolyGram	53,643	2,362		51,144	2,615	
PolyGram	3,802	(14)	(0.4)	7,201	549	7.6
Total	57,445	2,348		58,345	3,164	
Intersegment sales	(5,564)			(6,079)		
Sales	51,881			52,266		
Income from operations						
as a % of sales						
- excl. PolyGram		4.9			5.8	
- incl. PolyGram		4.5			6.1	

* The nine months period 1998 includes five months of PolyGram on a consolidated basis and four months on an unconsolidated basis.

** 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 September 1998			1998	1997
		% growth		September 30,	December 31,
	amount	nominal	comparable*		
Netherlands	2,612	18	27	3,534	3,720
United States	11,641	25	8	2,064	2,296
Germany	4,330	(1)	6	1,698	1,546
France	3,139	(5)	6	989	1,121
United Kingdom	2,907	8	10	713	747
Other countries	23,450	1	7	6,283	6,321
Total excl. PolyGram	48,079	7	8	15,281	15,751
PolyGram	3,802	(47)	(3)	–	3,922
Total	51,881	(1)	7	15,281	19,673

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

Segment revenues and income from operations

	January to September					
	1998			1997		
	segment revenues	income (loss) from operations	as % of segment revenues	segment revenues	income (loss) from operations	as % of segment revenues
Europe	44,450	2,119	4.8	40,515	1,474	3.6
USA and Canada	13,491	(308)	(2.3)	11,293	(27)	(0.2)
Latin America	3,571	(73)	(2.0)	3,431	79	2.3
Asia Pacific	17,026	624	3.7	18,126	1,086	6.0
Africa	202	–	–	178	3	1.7
Total excl. PolyGram	78,740	2,362		73,543	2,615	
PolyGram	3,802	(14)	(0.4)	7,201	549	7.6
Total	82,542	2,348		80,744	3,164	
Interregional sales	(30,661)			(28,478)		
Sales	51,881			52,266		
Income from operations						
as a % of sales						
- excl. PolyGram		4.9			5.8	
- incl. PolyGram		4.5			6.1	

'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.

Information also available on Internet, address: http://www.philips.com

Printed in the Netherlands

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

	3rd quarter		January to September	
	1998	1997	**1998***	1997
Sales	**16,126**	18,880	**51,881**	52,266
Income from operations	**511**	1,174	**2,348**	3,164
Financial income and expenses	**(228)**	(164)	**(512)**	(555)
Income before taxes	**283**	1,010	**1,836**	2,609
Income taxes	**(65)**	(252)	**(422)**	(652)
Income after taxes	**218**	758	**1,414**	1,957
Results relating to unconsolidated companies	**106**	(6)	**261**	38
Share of other group equity in group income	**125**	(31)	**344**	(121)
Income from normal business operations	**449**	721	**2,019**	1,874
Extraordinary items - net	**(24)**	711	**1,000**	1,192
Net income	**425**	1,432	**3,019**	3,066
Basic earnings per common share in NLG:				
- income from normal business operations	**1.24**	2.06	**5.61**	5.37
- net income	**1.17**	4.09	**8.39**	8.78

Consolidated statements of cash flows**

	3rd quarter		January to September	
	1998	1997	**1998***	1997
Cash flows from operating activities:				
Net income	**425**	1,432	**3,019**	3,066
Depreciation and amortization	**863**	933	**2,609**	2,706
Net gain on sale of investments	**(47)**	(863)	**(1,493)**	(1,604)
Increase in working capital	**(322)**	(553)	**(1,984)**	(2,141)
Decrease in provisions	**(105)**	(68)	**(205)**	(16)
Other items	**(56)**	297	**(338)**	606
Net cash generated by operating activities	**758**	1,178	**1,608**	2,617
Cash required for investments	**(1,057)**	(868)	**(3,284)**	(3,017)
Proceeds from divestments	**294**	1,552	**1,813**	3,045
Cash flows (before financing activities)	**(5)**	1,862	**137**	2,645

* The nine months period 1998 includes five months of PolyGram on a consolidated basis and four months 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.