

Report on the performance of the Philips Group

Philips made a number of accounting changes at the beginning of this year to make its financial statements more in conformity with US GAAP. In particular the changes relate to capitalizing IT software for internal Philips use, abolishing equalization accounts and using extraordinary items only under strict rules.

In September Philips Electronics and the Vereniging van Effectenbezitters - VEB reached an agreement to settle the litigation the VEB had initiated on behalf of a number of shareholders in December 1991.

The third quarter

Income from continuing operations in the quarter amounted to EUR 374 million (EUR 1.12 per share) as compared to EUR 147 million (EUR 0.41 per share) in the year ago quarter. Results were favorably impacted by improved business performance at Consumer Products, notably at Philips Consumer Communications (PCC), and to a lesser extent at Components.

Financial income and expenses were a positive EUR 7 million (income), compared with a negative EUR 104 million (expense) a year earlier, helped by a gain of EUR 43 million from the sale of marketable securities. Unconsolidated companies contributed EUR 99 million in the quarter, compared with a negative EUR 8 million a year ago, mostly as a result of the performance at the new LG.Philips LCD joint venture (net of goodwill amortization) and strong results at Taiwan Semiconductor Manufacturing Co. (TSMC).

Sales in the quarter of EUR 7,744 million were nominally 6 per cent higher than in the third quarter a year ago. Consolidation changes had a negative 3 per cent impact while changes in exchange rates had a 3 per cent positive impact. Comparable sales were up 6 per cent, compared with 3 per cent a year ago. Sales growth of 6 per cent in the quarter compares favorably with 2 per cent reached in the first six months of this year.

Price erosion in the quarter declined to 8 per cent compared with 10 per cent a year ago. Volume growth was 14 per cent compared with 13 per cent a year ago.

Income from operations before interest, income taxes and depreciation and amortization charges (EBITDA) amounted to EUR 801 million as compared to EUR 623 million in the 1998 quarter. EBITDA was up at most divisions, and was favorably impacted by lower organization cost, especially pension cost, and by the gain from the sale of assets at Semiconductors (EUR 18 million) and Components (EUR 6 million).

The first nine months

Income from continuing operations for the first nine months amounted to EUR 1,117 million (EUR 3.20 per share) compared to EUR 849 million (EUR 2.36 per share) in the corresponding period of 1998. Extraordinary items came to a loss of EUR 5 million and related to premiums paid in connection with the early repayment of long-term debt.

In 1998, total extraordinary income of EUR 454 million was primarily related to the divestments of Philips Car Systems and Optoelectronics B.V. Consequently, 1999 net income came to EUR 1,112 million versus EUR 1,370 million in 1998. The latter also included a EUR 67 million contribution from PolyGram as a discontinued operation.

Sales in 1999 amounted to EUR 21,879 million, nominally virtually unchanged from 1998. Exchange rate fluctuations had a positive effect on sales of less than 1 per cent, while consolidation changes caused a negative effect of 3 per cent. The most important deconsolidations were the Lucent share of PCC and Conventional Passive Components, partly offset by the consolidations of ATL Ultrasound and VLSI. Adjusted for these effects, the comparable sales growth came to 3 per cent versus 8 per cent a year ago. Consumer Products, Professional and Origin achieved above average sales growth. Semiconductors and the Miscellaneous sector reported negative growth rates. Price erosion of 8 per cent was slightly lower than the 9 per cent incurred in the corresponding period in 1998. Volume growth was 11 per cent compared with 17 per cent a year ago.

EBITDA in the first nine months came to EUR 2,496 million versus EUR 2,212 million in the year-earlier period. A large part of the difference originated from the sale of participations, mainly the gain on the sale of Conventional Passive Components in the first quarter, and from lower organizational cost, especially pension cost. Restructuring costs – mainly relating to AMLCD Waalre and Lighting – had an impact on income from operations of EUR 67 million, compared with EUR 16 million in 1998, while the impact of write-offs of in-process R&D on 1999 income was negative EUR 69 million, compared with nil in 1998. In addition, goodwill amortization charges affected 1999 income by EUR 93 million versus EUR 23 million in 1998. Higher income than in 1998 was recorded in the sectors Consumer Products, mainly due to the substantially reduced PCC losses and higher license income, and Origin. Income of the Lighting sector was virtually flat, while Semiconductors' income was affected by acquisition-related costs for VLSI.

Financial income and expenses came to a positive EUR 45 million (income) compared to last year's negative amount of EUR 227 million (expense). This was primarily due to lower net interest expense relating to the excess cash position, in addition to a EUR 73 million gain from the sale of some marketable securities in the past few months and EUR 21 million dividends from Seagram. The tax burden has been determined at a tentative rate of 20 per cent, compared with 23 per cent in the same period of last year.

Philips' results relating to unconsolidated companies came to EUR 140 million as compared to EUR 42 million in the year-earlier period. The increase was attributable to LG.Philips LCD's profitable start, as well as Taiwan Semiconductor Manufacturing Co., which is experiencing a strong recovery from last year's decline in the semiconductor industry. The share of other group equity in group income was negative EUR 35 million versus last year's positive share of EUR 156 million, which included Lucent's share in the losses of the PCC joint venture, which was dissolved in September 1998.

Trend per product sector – year to date

Growth is expressed on a comparable basis

Sales of the *Lighting* sector grew by 2 per cent, especially benefiting from strong performance in Automotive lighting. Income from operations came to EUR 447 million versus EUR 443 million in 1998. Restructuring charges were higher in 1999 than last year. In 1998, income was positively influenced by a substantial gain (EUR 21 million) from the sale of a factory building in Spain. The Automotive business realized the largest performance improvement.

Sales in the *Consumer Products* sector increased by 7 per cent. The growth was especially driven by PC Peripherals, notably Monitors, and Audio, as well as PCC. In Monitors, Audio and VCR, Philips has improved its market position. Although in Domestic Appliances and Personal Care sales picked up in the latest quarter especially due to strong Coolskin sales in the USA, sales for the full period are still slightly down on 1998. Income from operations improved to EUR 320 million from last year's EUR 44 million, mainly due to a significant reduction in the losses incurred at PCC, and higher license income. Consumer Electronics income was down on 1998, which had been favorably influenced by the soccer World Cup, especially the TV business.

The *Components* sector reported a 3 per cent increase in sales compared to the prior year. Flat Display Systems, which includes Cells & Modules, continues to show strong growth. Income from operations of EUR 203 million compares to last year's EUR 105 million, but includes EUR 191 million gains from the sale of participations, mainly Conventional Passive Components. Deterioration in income was primarily attributable to the decline in Optical Storage income in the first six months of the year. Income from AMLCD has significantly improved through better performance of Hosiden and Philips Display - HAPD - and year to date accumulated losses are lower than in 1998 in spite of a EUR 38 million restructuring charge for AMLCD Waalre.

In the *Semiconductors* sector sales decreased 2 per cent, excluding the sales contribution of VLSI from June 1, 1999, and was caused by lower sales of Consumer Systems and MultiMarket products. Income from operations was down to EUR 447 million from EUR 625 million. The consolidation of VLSI, and the related write-off of in-process R&D (EUR 47 million) and goodwill and other acquisition related charges (EUR 30 million) had a substantial negative impact on the results. Disregarding VLSI and Complex Programmable Logic Devices (CPLD), which was sold, income from operations came to 18.4 per cent of segment revenues versus 20.4 per cent in the year-earlier period. Margins are improving which reflects the current upturn in the business cycle, while in 1998 margins decreased in the latter half of the year.

Sales of the *Professional* sector were 4 per cent up on 1998. Medical Systems' sales were up 11 per cent which was significantly higher than the market growth. Business Electronics' sales were in line with 1998. Income from operations was EUR 25 million, down from EUR 109 million last year. Medical Systems' income in 1999 was adversely impacted by charges for reorganizations in Germany and in North America, while 1998 income benefited from one-time positive items. Business Electronics incurred a loss partly due to the write-off of in-process R&D relating to the acquisition of Voice Control Systems (EUR 7 million) in the second quarter and Micrion/FEI (EUR 9 million) in the third quarter, but mainly from substantial market and product development expenditures in Digital Video Systems, which are directed at establishing a stronger market presence in the digital set-top box market in the USA.

Sales growth at *Origin* came to 6 per cent. Income from operations of EUR 82 million was substantially up on last year's EUR 32 million, reflecting improved revenues and cost efficiency.

The *Miscellaneous* sector incurred a 16 per cent decrease in sales as a result of divestment. Income from operations was a loss of EUR 48 million compared to a loss of EUR 27 million a year earlier, due to lower results at Machinefabrieken and Plastics and Metalware Factories (PMF), some activities of which have been divested earlier this year.

Trend per geographic area – year to date

Growth is expressed on a comparable basis

Sales growth in the first nine months was particularly robust in North America (10 per cent) with all sectors contributing. Asia Pacific recorded 6% higher sales levels, particularly the Components and Consumer Products sectors, the latter especially due to strong sales in China. Europe saw 2 per cent growth reflecting an upward trend during the year, mainly attributable to the Consumer Products sector, which benefited from excellent PCC sales, especially in the UK. During the quarter positive sales growth was realized in Latin America after four sequential quarters of negative growth; year to date growth is still negative.

The largest income improvement arose in North America, which was profitable even despite the write-offs for in-process R&D and goodwill amortization for VLSI, Voice Control Systems (VCS) and Micrion/FEL. This was predominantly attributable to a substantial reduction of the PCC losses and positive contributions from Lighting, Components and Semiconductors excluding VLSI. European income decreased in spite of the gain on the divestment of Conventional Passive Components recorded in the first quarter. The losses in Latin America were reduced, especially in Brazil, which improved to virtually break-even results driven by Consumer Electronics and Components. Income in Asia Pacific was up, benefiting particularly from positive developments in Consumer Electronics and Components in China and Components' HAPD display activities in Japan.

Balance sheet ratios and cash flows

At the end of September 1999, inventories came to 16.6 per cent of sales, down from 17.5 per cent a year ago. Outstanding trade receivables were the equivalent of 1.6 months sales, basically unchanged from a year ago. A number of major acquisitions aimed at accelerating the company's profitable growth in selected areas as well as the share reduction program have reversed the net cash position that prevailed during the first six months, and which resulted from the sale of the company's shares in PolyGram in December 1998. The group's debt to equity ratio amounted to 10:90, which compares to 21:79 a year earlier. During 1999 investing activities required cash of EUR 4.1 billion, which was EUR 2.9 billion higher than in 1998, mainly caused by the acquisitions of VLSI, VCS, Micrion, the 50 per cent stake in LG.Philips LCD Co. and 10 per cent shareholding in Origin. The resulting cash flow deficit of EUR 2.8 billion compares with the EUR 0.3 billion surplus in the same period last year. Capital repayments to shareholders arising from the 8 per cent share reduction program came to EUR 1.5 billion.

Employees

The number of people employed at the end of September 1999 was 230,692, which is 1,139 less than the comparable position on January 1, 1999.

Outlook

The economic environment in Europe and Asia Pacific is improving and compares favorably with the second half of 1998.

Growth in the Semiconductors sector is accelerating and should favorably impact margins in the fourth quarter. Our objective to grow this year's earnings from continuing operations with double digits stays firm.

October 21, 1999
Royal Philips Electronics

Board of Management

Balance sheets and additional ratios

all amounts in millions of euros unless otherwise stated

Consolidated balance sheets

	1999 September 30,	1998 December 31,
Cash and cash equivalents	1,718	6,553
Receivables	6,432	5,442
Inventories	5,053	4,274
Non-current assets	14,592	11,884
Total assets	27,795	28,153
Other current liabilities	7,215	7,139
Debt	3,371	3,587
Provisions	3,062	2,985
Group equity	14,147	14,442
Of which stockholders' equity	13,846	14,200
<i>Per common share in EUR</i>	41.66	39.37

Number of common shares outstanding

	End of September	
Shares in thousands	339,079	368,495

Number of employees

Comparable figure on 1.1.1999 : 231,800	230,700	256,400
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Ratios

Net debt : group equity ratio	10:90	21:79
Inventories as a % of sales	16.6	17.5
Outstanding trade receivables, in months' sales	1.6	1.6
Income from operations:	January to September	
As a % of sales	5.6	4.9
As a % of net operating capital (RONA)	16.4	14.2
Income from continuing operations as a % of stockholders' equity (ROE)	11.8	13.0

Product sectors

all amounts in millions of euros unless otherwise stated

Sales and total assets

	sales (to third parties)			total assets	
	January to September 1999			1999	1998
	amount	% growth		September 30,	December 31,
		nominal	comparable *		
Lighting	3,299	2	2	2,750	2,607
Consumer Products	8,484	(4)	7	4,670	4,350
Components	2,666	(5)	3	4,960	3,112
Semiconductors	2,605	7	(2)	4,777	3,106
Professional	3,515	16	4	3,345	2,810
Origin	817	6	6	662	572
Miscellaneous	493	(30)	(16)	899	1,021
Unallocated				5,732	10,575
Total	21,879	0	3	27,795	28,153

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

Segment revenues and income from operations

	January to September					
	1999			1998		
	segment revenues	income (loss) from operations	as % of segment revenues	segment revenues	income (loss) from operations	as % of segment revenues
Lighting	3,333	447	13.4	3,286	443	13.5
Consumer Products	8,758	320	3.7	9,040	44	0.5
Components	3,802	203	5.3	3,856	105	2.7
Semiconductors	3,156	447	14.2	3,012	625	20.8
Professional	3,742	25	0.7	3,122	109	3.5
Origin	1,297	82	6.3	1,176	32	2.7
Miscellaneous	578	(48)	(8.3)	850	(27)	(3.2)
Unallocated		(256)			(259)	
Total	24,666	1,220		24,342	1,072	
Intersegment revenues	(2,787)			(2,525)		
Sales	21,879			21,817		
Income from operations						
as a % of sales		5.6			4.9	

Main countries and geographic areas

all amounts in millions of euros unless otherwise stated

Sales and fixed assets

	sales (to third parties)		(in) tangible fixed assets		
	January to September 1999		1999	1998	
	amount	% growth	September 30,	December 31,	
		nominal	comparable *		
Netherlands	1,199	1	2	1,782	1,633
United States	5,338	1	10	2,382	1,167
Germany	1,899	(3)	0	622	698
France	1,319	(7)	(8)	405	410
United Kingdom	1,607	22	23	316	298
China (incl. Hong Kong)	1,407	4	4	596	574
Other countries	9,110	(2)	0	3,765	2,348
Total	21,879	0	3	9,868	7,128

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

Segment revenues and income from operations

	January to September					
	1999			1998		
	segment revenues	income (loss) from operations	as % of segment revenues	segment revenues	income (loss) from operations	as % of segment revenues
Europe**	20,318	839	4.1	19,380	962	5.0
USA and Canada	6,592	49	0.7	6,122	(140)	(2.3)
Latin America	1,136	(6)	(0.5)	1,620	(33)	(2.0)
Asia Pacific	8,152	337	4.1	7,726	283	3.7
Africa	75	1	1.3	92	-	-
Total	36,273	1,220		34,940	1,072	
Interregional revenues**	(14,394)			(13,123)		
Sales	21,879			21,817		
Income from operations						
as a % of sales		5.6			4.9	

** Reclassified

'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. 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.

Statements of income and cash flows

all amounts in millions of euros (EUR) unless otherwise stated

The data included in this report are unaudited.

The 1998 data have been restated to reflect the sale of PolyGram N.V. and to present the Philips Group accounts on a continuing basis.

Consolidated statements of income

	3rd quarter		January to September	
	1999	1998	1999	1998
Sales	7,744	7,317	21,879	21,817
EBITDA	801	623	2,496	2,212
Income from operations (EBIT)	352	232	1,220	1,072
Financial income and expenses	7	(104)	45	(227)
Income before taxes	359	128	1,265	845
Income taxes	(72)	(29)	(253)	(194)
Income after taxes	287	99	1,012	651
Results relating to unconsolidated companies	99	(8)	140	42
Share of other group equity in group income	(12)	56	(35)	156
Income from continuing operations	374	147	1,117	849
Discontinued operations	-	57	-	67
Extraordinary items - net	(2)	(11)	(5)	454
Net income	372	193	1,112	1,370

Basic earnings per common share in EUR:

- income from continuing operations	1.12	0.41	3.20	2.36
- net income	1.11	0.53	3.19	3.81

Consolidated statements of cash flows*

	3rd quarter		January to September	
	1999	1998	1999	1998
Cash flows from operating activities:				
Net income	372	193	1,112	1,370
Income from discontinued operations	-	(57)	-	(67)
Depreciation and amortization	472	392	1,299	1,141
Net gain on sale of investments	(77)	(22)	(386)	(678)
Increase in working capital	(552)	(146)	(1,234)	(914)
Decrease in provisions	(20)	(48)	(117)	(49)
Other items	105	1	(208)	(65)
Net cash provided by operating activities	300	313	466	738
Cash used for investments	(2,118)	(482)	(4,100)	(1,237)
Proceeds from divestments	70	136	790	821
Cash flows (before financing activities)	(1,748)	(33)	(2,844)	322

* 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.