

# Report on the performance of the Philips Group

- all amounts in millions of euros unless otherwise stated
- the data included in this report are unaudited
- financial reporting according to US GAAP



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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).

By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include, but are not limited to, levels of consumer and business spending in major economies, changes in consumer tastes and preferences, changes in law, the performance of the financial markets, pension costs, the levels of marketing and promotional expenditures by Philips and its competitors, raw materials and employee costs, changes in future exchange and interest rates (in particular, changes in the euro and the US dollar can materially affect results), changes in tax rates and future business combinations, acquisitions or dispositions and the rate of technological changes.

**Philips reports full year income from operations of EUR 420 million, a net loss of EUR 3,206 million, including impairment charges of EUR 3,260 million.**

**Fourth quarter income from operations of EUR 47 million, a net loss of EUR 1,530 million, including special items of EUR 1,588 million.**

- 12% higher unit sales, 4% lower nominal sales than in Q4 2001
- Lighting and DAP record income from operations in Q4
- Solid performance of Consumer Electronics and Medical Systems in Q4
- Cash flow from operations of EUR 1,442 million in Q4
- All-time low inventories: 11.1 % of sales
- Net debt reduced by EUR 1.7 billion – net debt : group equity ratio 27:73
- Cost reduction programs on-track

## The fourth quarter 2002

Philips recorded a net loss of EUR 1,530 million (a loss of EUR 1.20 per share), versus a loss of EUR 1,062 million (a loss of EUR 0.84 per share) in the same period last year. Income of Q4 2002 included impairment charges of EUR 1,340 million (EUR 921 million for Atos Origin and EUR 275 million for LG.Philips Displays) and other special charges of EUR 248 million, whilst last year's quarter included impairment charges of EUR 526 million (mainly for Vivendi Universal), and other net special charges of EUR 433 million. Excluding special items, net income came to a profit of EUR 58 million versus a loss of EUR 103 million last year. Sales decreased by 4% over the same period of last year, mainly due to the weakening of the US dollar and related currencies which had a 7% negative impact. Unit sales were 12% higher, continuing the improving trend quarter over quarter. Income from operations improved from a loss of EUR 458 million in Q4 2001 to a profit of EUR 47 million this year. The improvement, which compensated for EUR 150 million of higher pension costs, comes mainly from higher margins and lower costs, including lower amortization of goodwill of EUR 51 million.

The cost reduction programs are on-track, with full year reduction in overhead costs amounting to EUR 257 million (EUR 324 million on a run rate basis in Q4), and integration savings realized at Philips Medical Systems of EUR 173 million in 2002. Results from unconsolidated companies came to a loss of EUR 1,391 million, largely caused by EUR 1,260 million of impairment charges and EUR 142 million of other special charges. Cash flow from operating activities was EUR 1,442 million, mainly from tight capital management. Inventories as a percentage of sales came to a record low of 11.1%, compared to 13.3% last year. During the quarter the net debt was reduced by EUR 1.7 billion to EUR 5.25 billion, resulting from the strong cash flow from operations.

**Gerard Kleisterlee,**  
Philips' President and CEO:

“We are encouraged by our operational results for the fourth quarter in a continuing difficult and uncertain marketplace, and we move into 2003 focused on improving profitable operational performance.

The economic outlook is covered with uncertainties, and as such we will continue our stance of 2002 – further reducing costs, best-in-class supply chain management, cash flow management and debt reduction, and product and marketing innovation.

We have demonstrated that we are fully on-track to achieve our EUR 1 billion cost reduction initiatives, and divestment program of EUR 1 billion in non-core activities. We have maintained a strong balance sheet and reduced our net debt position, which we will continue to do during the current year.

2002 saw us make good progress on strengthening the cooperation between our businesses and creating a more cohesive market orientated company – ‘One Philips’.”

## Net income excluding special items

in millions of euros unless otherwise stated

	Q4 2002	Q4 2001
As published	(1,530 )	(1,062 )
Special items:		
Affecting income from operations	(254 )	(497 )
Affecting financial income and expenses	(80 )	(526 )
Affecting results from unconsolidated companies	(1,402 )	(45 )
Taxes related to special items	148	109
Excluding special items	58	(103 )

## Group sales and composition of changes (%)

in millions of euros unless otherwise stated

	Q4 2002	Q4 2001
Philips group sales	8,923	9,262
% change from the previous year:		
Nominal change	(4 )	(16 )
Consolidation changes	(2 )	2
Currency effects	(7 )	(2 )
Comparable change	5	(16 )
Prices	(7 )	(9 )
Volume	12	(7 )

## Sales by sector

in millions of euros unless otherwise stated

	Q4 2002	Q4 2001	% change	
			nominal	comparable
Lighting	1,295	1,350	(4 )	3
Cons. Electronics	2,876	3,248	(11 )	0
DAP	776	775	0	9
Components	686	575	19	25
Semiconductors	1,006	940	7	17
Medical Systems	1,883	1,916	(2 )	3
Miscellaneous	401	458	(12 )	6
Philips group	8,923	9,262	(4 )	5

## Income from operations

in millions of euros

	Q4 2002	Q4 2001
Income from operations excluding special items and amortization of goodwill	301	90
Special items	(254 )	(497 )
Amortization of goodwill	-	(51 )
Income from operations	47	(458 )

## Highlights in the quarter

### Group sales and income

*Sales* in Q4 were EUR 8,923 million, 22% up from the third quarter. Compared with Q4 of last year, nominal sales were 4% lower. Changes in consolidations had a negative effect of 2% on balance. Sales were affected by weaker currencies, resulting in a 7% negative impact. Comparable sales growth in Q4 came to 5%, accelerating from Q3 when sales increased 2% on a comparable basis. Price erosion remained at 7%, whilst unit sales grew with 12%, having improved every quarter in 2002. All sectors posted positive comparable growth, in particular Components, Semiconductors and Domestic Appliances and Personal Care (DAP). Geographically, sales rose strongly in Asia Pacific, in addition to a small rise in Europe. Weaker sales were posted in Latin America and North America. The latter was caused exclusively by the weak dollar, which had a downward effect on sales of 13% in the region.

*Income from operations* came to a profit of EUR 47 million including net special charges of EUR 254 million. Excluding special items a profit of EUR 301 million would have been realized. The improvement in income from operations, excluding special items, was EUR 211 million, including a negative EUR 150 million comparison in pension expense. Improvement in income from operations came from higher margins and lower costs, including lower amortization of goodwill. The cost reduction programs are on-track, with overhead reductions on a run rate basis during Q4 at EUR 324 million.

The most significant special items included in the quarter were:

- Gain on sale of Philips Contract Manufacturing Services (PCMS) of EUR 83 million and related restructuring charges of EUR 93 million.
- Gain on sale of Communication, Security and Imaging business of EUR 71 million.
- Restructuring charges at Components, including Optical Storage, of EUR 167 million.
- Restructuring charges at Semiconductors of EUR 180 million.

### Income from operations by sector (excl. special items and amortization of goodwill)

in millions of euros

	Q4 2002	Q4 2001
Lighting	182	143
Consumer Electronics	146	33
DAP	186	148
Components	(74)	(102)
Semiconductors	(140)	(214)
Medical Systems	218	192
Miscellaneous	(121)	(104)
Unallocated	(96)	(6)
Total	301	90
Income from operations (as published)	47	(458)

### Financial income and expenses

in millions of euros

	Q4 2002	Q4 2001
Financial income and expenses excluding special items	(73)	(141)
Special items	(80)	(526)
Total	(153)	(667)

### Results relating to unconsolidated companies

in millions of euros

	Q4 2002	Q4 2001
Results excluding special items and amortization of goodwill	11	30
Special items	(1,402)	(45)
Amortization of goodwill	-	(70)
Total	(1,391)	(85)

Last year's special items amounted to EUR 497 million and included acquisition related charges at Medical Systems of EUR 222 million and various restructuring charges of EUR 249 million.

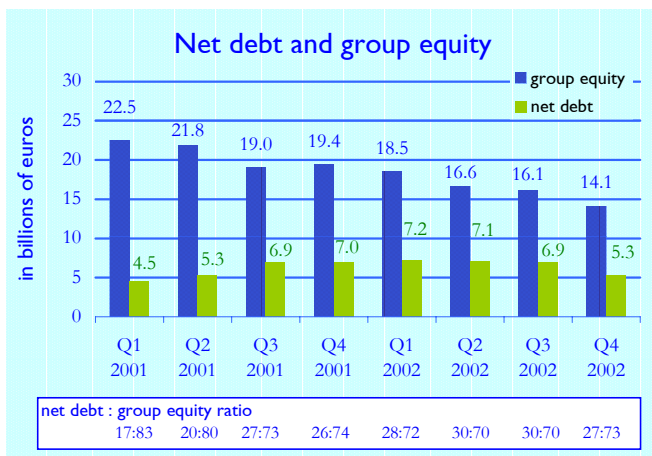
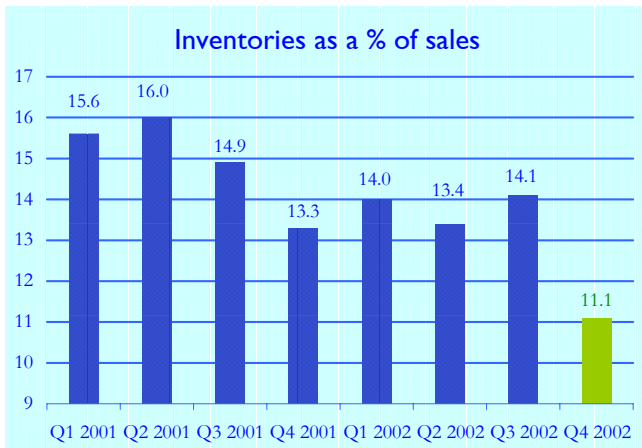
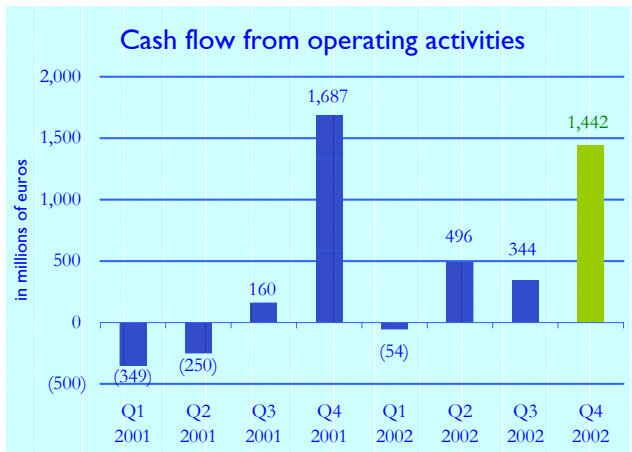
Excluding special items, income from operations improved in all product sectors except at Miscellaneous and Unallocated. Income of Miscellaneous was impacted by charges for environmental provisions, whilst in Unallocated pension credits were lower. Lighting, Consumer Electronics (CE), DAP and Medical Systems posted strong profits, while Semiconductors and Components reduced their losses. CE improved its income from operations by EUR 113 million over the same period last year.

*Financial income and expenses* amounted to a net expense of EUR 153 million and included impairment charges of EUR 80 million for JDS Uniphase and Great Nordic. The fourth quarter of 2001 was impacted by impairment charges of EUR 526 million for Vivendi Universal and Great Nordic. Excluding these charges, net interest expenses were significantly lower compared to last year. The variance was largely due to a lower debt position in 2002 compared to 2001.

*Income tax* has been adjusted in the fourth quarter, based upon the final calculated tax burden for the full year, resulting in a tax charge of EUR 28 million in Q4.

Philips' *Results from unconsolidated companies* came to a loss of EUR 1,391 million for the quarter, largely impacted by impairment charges of EUR 1,260 million and a net EUR 142 million of other special charges.

Impairment charges were taken for Atos Origin (EUR 921 million), LG.Philips Displays (EUR 275 million), Philips' venturing portfolio and other holdings (EUR 64 million). The other special items were mainly related to restructuring and asset impairment charges of EUR 147 million at LG.Philips Displays.



## Cash flows and financing

Cash flow from operations in Q4 amounted to EUR 1,442 million.

Net capital expenditures of EUR 360 million were EUR 66 million higher than the same period last year, primarily attributable to investments at Semiconductors' joint facility in Crolles, France.

A reset of currency hedges generated a cash inflow of EUR 120 million.

Sale of businesses contributed EUR 430 million to the cash flow from investing activities. The main proceeds from divestments were related to the sale of PCMS amounting to EUR 170 million, the sale of Communication, Security and Imaging amounting to EUR 156 million and the sale of Health Care Products (HCP) of EUR 85 million. Outflows included a payment of EUR 32 million for the recent acquisition of Systemonic at Semiconductors.

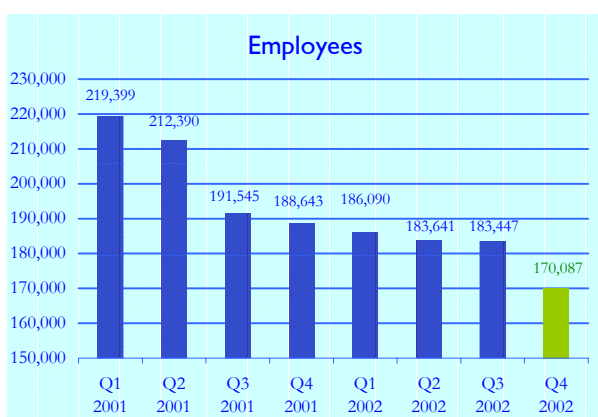
In 2001, cash flow from investing activities included an outflow of EUR 1.2 billion associated with the acquisition of Marconi's medical business.

The cash conversion cycle was further reduced to 18 days, a decline of 16 days compared to the same period last year. The improvement is a result of better working capital management in all sectors, and CE in particular. Inventories as percentage of sales came to a record-low of 11.1% compared to 13.3% last year; the sixth consecutive quarter inventories have been managed to record-low levels.

The net debt : group equity ratio ended the quarter at 27:73.

During the quarter the net debt position decreased by EUR 1.7 billion to EUR 5.25 billion, mainly due to the strong cash flow from operations. Group equity was negatively impacted by the net loss of EUR 1,530 million, which included impairment charges of EUR 1,340 million.

Furthermore, group equity was reduced due to negative translation differences of EUR 368 million and adjustments for pension liabilities of EUR 342 million, mainly related to underfunding in the U.S. and U.K.



## Employment

At the end of December 2002, the total number of employees was 170,087. Compared with the end of Q3, headcount decreased by 13,360. More than half of the reduction (7,340) was related to deconsolidations, of which PCMS was the largest (4,460). On a comparable basis, headcount decreased by 6,099, of which 1,712 were temporary employees. The most significant reductions were at Lighting, Consumer Electronics, Semiconductors and Miscellaneous.

### Lighting: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	1,295	1,350
Sales growth		
% increase, nominal	(4)	(4)
% increase, comparable	3	(3)
Income from operations	183	142
IFO excluding special items and amortization of goodwill:		
in % of sales	14.1	10.6
Net operating capital (NOC)	1,723	1,979
Number of employees (FTEs)	46,870	47,922

### Consumer Electronics: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	2,876	3,248
Sales growth		
% increase, nominal	(11)	(19)
% increase, comparable	0	(17)
Income from operations	130	(7)
IFO excluding special items and amortization of goodwill:		
in % of sales	5.1	1.0
Net operating capital (NOC)	28	672
Number of employees (FTEs)	20,080	31,525

## Sales and income from operations per sector

Comparable sales growth at *Lighting* in the fourth quarter was 3%. Sales in Asia Pacific continued their positive trend, whilst market share was gained in North America. Income from operations was EUR 41 million better than last year with improvements in all businesses except Luminaires. The improvement in profitability from 10.6% last year to 14.1% in 2002, was mainly as a result of successful price management, a favourable product mix and tight cost control. Reduction in net operating capital was mostly driven by a lower asset base and improved working capital management.

Sales at *Consumer Electronics* decreased by 11%, however comparable sales were flat versus Q4 2001, mainly due to Digital Networks. DVD realized growth of 41%; TV and Audio grew by 4%, while Monitors fell 7%. Sales of GSM phones remained at the 2001 level. Income from operations at Consumer Electronics improved considerably versus last year, with almost all businesses profitable. In North America income improved significantly, from a loss of EUR 103 million in Q4 of last year to a loss of EUR 23 million this year. License income was lower than last year, mainly due to weaker currency rates and the expiration of certain patents related to CD, only partly compensated by higher income related to DVD.

### DAP: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	776	775
Sales growth		
% increase, nominal	0	0
% increase, comparable	9	1
Income from operations	183	143
IFO excluding special items and amortization of goodwill:	186	148
in % of sales	24.0	19.1
Net operating capital (NOC)	529	652
Number of employees (FTEs)	8,766	9,527

### Components: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	686	575
Segment revenues	743	650
Sales growth		
% increase, nominal	19	(54)
% increase, comparable	25	(24)
Income from operations	(226)	(139)
IFO excluding special items and amortization of goodwill:	(74)	(102)
in % of segment revenues	(10.0)	(15.7)
in % of sales	(10.8)	(17.7)
Net operating capital (NOC)	118	397
Number of employees (FTEs)	13,005	15,107

### Semiconductors: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	1,006	940
Segment revenues	1,112	1,073
Sales growth		
% increase, nominal	7	(44)
% increase, comparable	17	(43)
Income from operations	(312)	(292)
IFO excl. special items and amortization of goodwill:	(140)	(214)
in % of segment revenues	(12.6)	(19.9)
in % of sales	(13.9)	(22.8)
Net operating capital (NOC)	3,606	4,742
Number of employees (FTEs)	31,185	32,740

DAP recorded a comparable sales increase of 9%, driven by higher sales in Oral Healthcare and Food & Beverage, with the Sonicare toothbrush showing strong growth and the regional sales expansion of the Senseo coffee machine.

Increases in market share were realized in Beverage and Oral Healthcare in the US, whilst Floor and Garment Care also improved their market position. The launch of Sensotec shaver in the fourth quarter was well received, especially in the U.S. Income from operations, excluding special items, increased with almost 5% to 24% of sales. The increase resulted from improved gross margins in all businesses, and generally lower costs.

Components' fourth quarter comparable sales showed 25% growth compared to Q4 last year. Sequential growth was 35%. Sales improvements were seen in all businesses, including a 59% increase in Mobile Display Systems. Revenues from color displays were approximately 45% of the total.

Excluding EUR 152 million special items in the fourth quarter, the Components division is yet to recover to profitability, but nevertheless achieved significant improvement compared to the fourth quarter of last year, driven by improved sales levels and cost savings. The restructuring charges for dissolving the division and bringing businesses back to profitability amounted to EUR 167 million. These charges were partly offset by other small special gains.

Semiconductors' sequential sales growth amounted to 4%.

Compared to Q4 2001, growth came to 7%. The book-to-bill ratio at the end of Q4 was 0.87 versus 0.74 at the end of Q3. Due to a pause in the pick-up of the order book in Q4, outsourcing to SSMC and production levels were reduced, leading to lower inventories which had been built-up in Q3. As a result of these measures, the utilization rate came to 52% in Q4, 6% lower than in Q3, and income from operations was negatively impacted by approximately EUR 50 million.

Excluding special items, income from operations came to a loss of EUR 140 million in Q4 compared to a loss of EUR 65 million in Q3. Special items included various restructuring charges totalling EUR 180 million mainly related to the earlier announced plans to close the semiconductor plant in Albuquerque. Given that this closure will take almost a year to complete, the excess in book value of the assets over their fair value (approximately EUR 100 million) will be charged to income, EUR 30 million of which was already taken in Q4 2002. The remaining charges will be spread over the first three quarters of 2003.

### Medical Systems: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	1,883	1,916
Sales growth		
% increase, nominal	(2)	86
% increase, comparable	3	13
Income from operations	239	(129)
IFO excluding special items and amortization of goodwill:		
in % of sales	11.6	10.0
Net operating capital (NOC)	4,849	5,418
Number of employees (FTEs)	31,027	30,993

### Miscellaneous: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Sales	401	458
Sales growth		
% increase, nominal	(12)	(47)
% increase, comparable	6	(26)
Income from operations	(55)	(138)
IFO excluding special items and amortization of goodwill:		
in % of sales	(30.2)	(22.7)
Net operating capital (NOC)	(73)	314
Number of employees (FTEs)	14,839	15,366

### Unallocated: key data

in millions of euros unless otherwise stated	Q4 2002	Q4 2001
Corporate and regional overheads	(101)	(125)
Pensions	6	87
Income from operations	(95)	(38)
Number of employees (FTEs)	4,315	5,463

*Medical Systems'* comparable sales showed a positive growth of 3%. Sales growth came from all regions, especially North America, and from all business lines.

Income from operations was a profit of EUR 239 million, including a special net gain of EUR 21 million. Integration charges were more than offset by the partial release of acquisition related provisions. Income from operations as a % of sales, excluding special items, came to 11.6% and was primarily driven by integration savings and improved margins. For the full year integration savings of EUR 173 million were realized.

The decrease in NOC was mainly influenced by a lower US dollar and the divestment of HCP as of November (year-to-date sales of HCP were approximately EUR 550 million).

Income of *Miscellaneous* came to a loss of EUR 55 million and included a gain on the sale of Communication, Security and Imaging business of EUR 71 million. This divestment delivered EUR 156 million of cash in the quarter. Income before special items amounted to a loss of EUR 121 million. This result was negatively affected by charges of EUR 29 million for the increase of environmental provisions, of which EUR 20 million was related to asbestos claims in connection with a U.S. subsidiary that ceased activities in 1981.

Corporate and regional overhead costs in *Unallocated* were 19% lower than the same period last year. Pension credits in this sector were EUR 81 million lower.

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

in millions of euros

	<b>Q4 2002</b>	<b>Q4 2001</b>
SSMC	(15)	(18)
LG.Philips LCD	(23)	(9)
LG.Philips Displays	34	(24)
Others	15	81
Total	11	30

### LG.Philips LCD joint venture (100%)

in millions of euros unless otherwise stated

	<b>Q4 2002</b>	<b>Q4 2001</b>
Sales	727	604
Sales growth % increase, nominal	20	18
Income from operations in % of sales	(57) (7.8)	3 0.5
Net income (100%)	(46)	(18)
Net income (Philips share = 50%)	(23)	(9)
Net income (Philips share = 50%, incl. amortization of goodwill)	(23)	(31)
Net operating capital (NOC)	2,776	2,605
Number of employees (FTEs)	5,879	4,797

### Results related to unconsolidated companies

Results relating to unconsolidated companies, excluding special items and amortization of goodwill, fell by EUR 19 million from last year. Sequentially, results improved by EUR 8 million, mainly attributable to improved contributions from LG.Philips Displays. This improvement came primarily from insurance payments related to business interruption damages and the sale of intellectual property.

### LG.Philips LCD joint venture

Q4 witnessed some recovery in LCD panel shipments, after the clearance of inventory build-up in OEMs in Q3, but a significant recovery in end-user demand is not present as yet. Continued price erosion was present during the quarter. Average prices declined by approximately 20%.

Before currency exchange effects, sales grew sequentially by 5% and 20% from Q4 2001. Income from operations for the quarter was a loss of EUR 57 million, mainly caused by the continued price erosion of 20% per quarter.

Philips' share in net income was a loss of EUR 23 million compared to a profit of EUR 28 million in Q3 of 2002.

## The year 2002

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

## Impairments/value adjustments shareholdings and securities

in millions of euros

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

## Net income excluding special items

in millions of euros

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

## Highlights full year

### Summary

Markets in 2002 were a repeat of the markets in 2001. The telecommunications and PC-related markets and business investments in IT products and services in general continued to suffer during 2002. These markets seemed to be starting to recover in the first quarter, but the improvements did not follow through during the rest of the year. Philips' management focused its attention on managing those activities it *can* control: costs, cash flow, tight asset control, strengthening its innovation and other operational processes, and reducing debt. As a result, margins in all our divisions improved compared with 2001.

Furthermore, 2002 net income was positively impacted by savings resulting from our overhead cost reduction program (EUR 257 million) and lower goodwill amortization (EUR 413 million) and adversely affected by a significant increase in pension costs (EUR 541 million). Philips was able to generate a EUR 2,228 million positive cash flow from operating activities. Gross capital expenditures were scaled back compared with 2001, to EUR 1,161 million.

### Special items

Main financial markets around the world closed with negative results for the third year in a row, impacting the valuation of the Company's financial assets. During 2002 the Company took charges of EUR 1,955 million for writing down the valuation of its securities (mainly Vivendi Universal). Also, the Company took impairment charges totaling EUR 1,305 million for its shareholdings in unconsolidated companies (mainly Atos Origin and LG.Philips Displays). Other special items that impacted the Company's income from operations were:

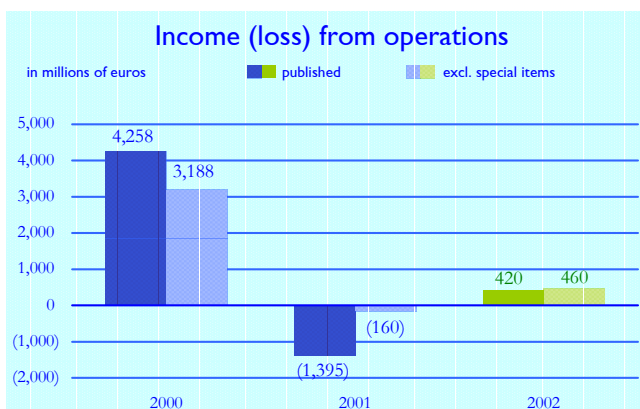
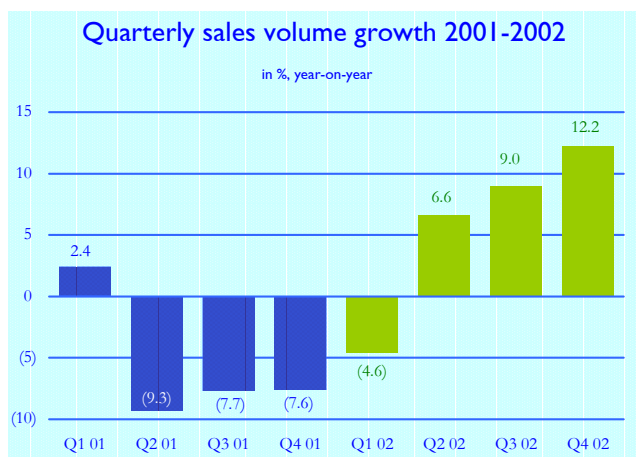
- restructuring expenses and asset impairments of EUR 513 million in our divisions and EUR 301 million with respect to our unconsolidated companies;
- acquisition-related charges of EUR 96 million, mainly at Philips Medical Systems; and
- gains from the sale of businesses or assets, which made a positive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

Excluding all special items, net income would have been EUR 208 million.

## Continued weak markets in 2002

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

\* provisional data



## Group sales and income from operations

### Sales

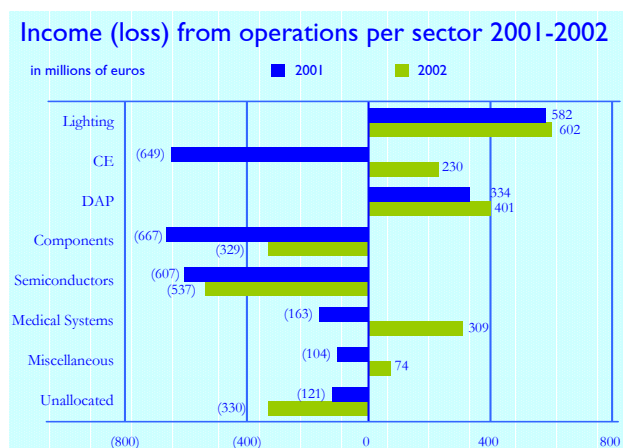
Sales in 2002 totaled EUR 31,820 million, 2% lower than in 2001. Changes in consolidation had a net positive effect of 3%, while the weakening of the dollar and related currencies had a 4% negative effect, particularly in the second half of the year. Sales volume grew by 6%, in contrast to a 6% decline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

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

### Income from operations

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

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



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

### Income (loss) from operations

in millions of euros

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

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

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

### Special items affecting income (loss) from operations

in millions of euros

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

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

## Other information

To enhance transparency and provide investors with a better understanding of the economic performance of Philips, it has been decided to introduce fair value recognition for stock-based compensation. Commencing January 1, 2003, the fair value of stock-based compensation awarded to management and employees will be charged to income, in accordance with the provisions of FAS 123.

On January 22, 2003, a jury in Raleigh, North Carolina, USA, delivered a verdict of approximately USD 152 million to Volumetrics, Inc. against the Philips Ultrasound business of Philips Medical Systems. The claim relates to the decision of Philips not to collaborate with or acquire Volumetrics at a point in time when Philips was in discussions with Agilent Technologies, Inc. to purchase its Health Care Solutions Group. The verdict is not a judgement, and is subject to review by the trial judge, which is expected in March, 2003.

Philips believes that the facts of the case do not support the verdict.

## Proposed distribution to shareholders

Pursuant to article 38 of the Articles of Association, and with the approval of the Supervisory Board and the Meeting of Priority Shareholders, a proposal will be submitted to the General Meeting of Shareholders to make a distribution in cash to shareholders of EUR 0.36 per common share (2001: a distribution was made of EUR 0.36 per common share).

## Annual Report 2002

More details on the performance of the Philips Group on the year 2002 can be found in the Annual Report 2002 of Royal Philips Electronics, and at [www.philips.com](http://www.philips.com).

## Outlook

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

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

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

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

Amsterdam, February 11, 2003

Board of Management

# Statements of income

all amounts in millions of euros unless otherwise stated

## Consolidated statements of income

	4 <sup>th</sup> quarter		January to December	
	2002	2001	2002	2001
Sales	8,923	9,262	31,820	32,339
Cost of sales	(6,041)	(6,544)	(21,906)	(23,240)
<b>Gross margin</b>	<b>2,882</b>	<b>2,718</b>	<b>9,914</b>	<b>9,099</b>
Selling expenses	(1,458)	(1,473)	(5,017)	(5,027)
General and administrative expenses	(389)	(348)	(1,404)	(1,249)
Research and development expenses	(746)	(908)	(3,043)	(3,312)
Write-off of acquired in-process R&D	(8)	(55)	(12)	(106)
Restructuring and impairment charges	(423)	(266)	(503)	(786)
	<b>(3,024)</b>	<b>(3,050)</b>	<b>(9,979)</b>	<b>(10,480)</b>
Other business income (expenses) - net	189	(126)	485	(14)
Income (loss) from operations	47	(458)	420	(1,395)
Financial income and expenses:				
– interest	(85)	(135)	(384)	(391)
– impairment charges	(80)	(526)	(1,955)	(526)
– other	12	(6)	112	2
	<b>(153)</b>	<b>(667)</b>	<b>(2,227)</b>	<b>(915)</b>
Income before taxes	(106)	(1,125)	(1,807)	(2,310)
Income taxes	(28)	130	(27)	428
Income after taxes	(134)	(995)	(1,834)	(1,882)
Results relating to unconsolidated companies:				
– impairment charges	(1,260)	(21)	(1,305)	(119)
– other	(131)	(64)	(41)	(489)
Minority interests	(5)	18	(26)	15
<b>Net income</b>	<b>(1,530)</b>	<b>(1,062)</b>	<b>(3,206)</b>	<b>(2,475)</b>
<b>Income from operations</b>				
as a % of sales	0.5	(4.9)	1.3	(4.3)
as a % of net operating capital (RONA)			3.2	(9.3)
<b>Weighted average number of common shares outstanding during the period (in thousands):</b> (after deduction of treasury stock)				
• basic			1,274,950	1,278,077
• diluted			1,279,002	1,286,544
<b>Net earnings per common share in euros:</b>				
• basic	(1.20)	(0.84)	(2.51)	(1.94)
• diluted	(1.20)	(0.84)	(2.51)	(1.94)

The Group financial statements have been prepared on a basis consistent with US GAAP, which differs in certain respects from Dutch GAAP. Net income determined in accordance with Dutch GAAP amounted to a loss of EUR 3,602 million in 2002, compared to a loss of EUR 2,608 million last year. These aggregate amounts result in basic earnings per common share of a loss of EUR 2.83 in January-December 2002 compared to a loss of EUR 2.04 last year. As of January 1, 2002 the US GAAP treatment of available for sale securities and the US GAAP rules for profit recognition on sale and lease-back transactions are also applied for the determination of Dutch GAAP net income and stockholders' equity; the remaining difference between Dutch GAAP and US GAAP is caused by the fact that goodwill is no longer amortized under US GAAP from January 1, 2002 but instead tested for impairment.

## Balance sheets and additional ratios

all amounts in millions of euros unless otherwise stated

### Consolidated balance sheets

	<b>Dec. 31, 2002</b>	Dec. 31, 2001
Cash and cash equivalents	1,858	890
Receivables and other current assets	5,671	6,670
Inventories	3,522	4,290
Unconsolidated companies	6,089	7,552
Other non-current financial assets	1,306	3,481
Non-current receivables and other non-current assets	2,772	3,080
Property, plant and equipment	6,137	7,718
Intangible assets - net	4,934	5,521
<b>Total assets</b>	<b>32,289</b>	39,202
Accounts payable and other liabilities	7,836	8,234
Debt	7,109	7,866
Provisions	3,246	3,740
Minority interests	179	202
Stockholders' equity	13,919	19,160
<b>Total liabilities and stockholders' equity</b>	<b>32,289</b>	39,202
<b>Number of common shares outstanding at the end of period</b>		
• shares in thousands	1,275,978	1,274,172
<b>Ratios</b>		
Stockholders' equity, per common share in euros	10.91	15.04
Inventories as a % of sales	11.1	13.3
Outstanding trade receivables, in months' sales	1.3	1.5
Net debt : group equity ratio	27:73	26:74

Stockholders' equity determined in accordance with Dutch GAAP amounted to EUR 13,407 million as of December 31, 2002 compared to EUR 13,919 million under US GAAP.

The deviation is caused by the fact that goodwill under Dutch GAAP has to be amortized and charged to income, whereas under US GAAP it is no longer amortized, but instead tested for impairment.

## Statements of cash flows

all amounts in millions of euros unless otherwise stated

### Consolidated statements of cash flows \*

	4 <sup>th</sup> quarter		January to December	
	2002	2001	2002	2001
<b><i>Cash flows from operating activities:</i></b>				
Net income (loss)	<b>(1,530)</b>	(1,062)	<b>(3,206)</b>	(2,475)
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	<b>664</b>	721	<b>2,184</b>	2,671
Impairment of equity investments	<b>1,360</b>	547	<b>3,260</b>	645
Net gain on sale of assets	<b>(172)</b>	(56)	<b>(643)</b>	(337)
Loss from unconsolidated companies (net of dividends received)	<b>116</b>	33	<b>54</b>	501
Minority interests (net of dividends paid)	<b>5</b>	2	<b>26</b>	(21)
Decrease in working capital	<b>1,165</b>	1,709	<b>815</b>	752
Decrease (increase) in non-current receivables/other assets	<b>60</b>	(550)	<b>86</b>	(888)
(Decrease) increase in provisions	<b>(219)</b>	337	<b>(336)</b>	313
Other items	<b>(7)</b>	6	<b>(12)</b>	87
<b>Net cash provided by operating activities</b>	<b>1,442</b>	1,687	<b>2,228</b>	1,248
<b><i>Cash flows from investing activities:</i></b>				
Purchase of intangible assets (software)	<b>(41)</b>	(83)	<b>(149)</b>	(234)
Capital expenditures on property, plant and equipment	<b>(379)</b>	(349)	<b>(1,161)</b>	(2,143)
Proceeds from disposals of property, plant and equipment	<b>60</b>	138	<b>370</b>	221
Proceeds from sale (purchase) of other non-current financial assets and derivatives	<b>110</b>	6	<b>505</b>	473
Proceeds from sale of businesses (purchase of businesses)	<b>393</b>	(1,294)	<b>187</b>	(2,881)
<b>Net cash provided by (used for) investing activities</b>	<b>143</b>	(1,582)	<b>(248)</b>	(4,564)
<b>Cash flows before financing activities</b>	<b>1,585</b>	105	<b>1,980</b>	(3,316)

\* 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.

## Statements of cash flows (continued)

all amounts in millions of euros unless otherwise stated

### Consolidated statements of cash flows (continued)\*

	4 <sup>th</sup> quarter		January to December	
	2002	2001	2002	2001
<b>Cash flows before financing activities</b>	<b>1,585</b>	105	<b>1,980</b>	(3,316)
<i>Cash flows from financing activities:</i>				
(Decrease) increase in debt	(515)	79	(419)	3,953
Treasury stock transactions	11	4	(19)	(336)
Dividends paid	-	-	(459)	(458)
<b>Net cash (used for) provided by financing activities</b>	<b>(504)</b>	83	<b>(897)</b>	3,159
<b>Increase (decrease) in cash and cash equivalents</b>	<b>1,081</b>	188	<b>1,083</b>	(157)
Effect of changes in exchange rates and consolidations on cash positions	(45)	4	(115)	(42)
Cash and cash equivalents at beginning of the period	822	698	890	1,089
<b>Cash and cash equivalents at end of period</b>	<b>1,858</b>	890	<b>1,858</b>	890

\* 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.

## Statement of changes in stockholders' equity

all amounts in millions of euros unless otherwise stated

### Consolidated statements of changes in stockholders' equity

	January to December 2002								
	Common stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)			Treasury shares at cost	Total stockholders' equity	
			Translation differences	Available for sale securities	Minimum pension liability	Cash flow hedges			
Balance as of January 1, 2002	263	13	20,403	(766)	566	(18)	(7)	(1,294)	19,160
Net income (loss)			(3,206)						(3,206)
Net current period change				(906)	(2,189)	(335)	(28)		(3,458)
Reclassifications into income				(40)	1,888		46		1,894
<b>Total comprehensive income (loss)</b>			(3,206)	(946)	(301)	(335)	18		(4,770)
Dividend paid			(459)						(459)
Purchase of treasury stock								(103)	(103)
Re-issuance of treasury stock								90	90
Stock options accrual		1							1
Balance as of December 31, 2002	263	14	16,738	(1,712)	265	(353)	11	(1,307)	13,919

## Product sectors

all amounts in millions of euros unless otherwise stated

### Segment revenues and income from operations

	2002			4 <sup>th</sup> quarter			
	segment revenues	Income (loss) from operations		segment revenues	Income (loss) from operations*		
		amount	as % of segment revenues		US GAAP basis	before amortization goodwill	as % of segment revenues
Lighting	1,302	183	14.1	1,358	142	144	10.6
Consumer Electronics:							
Mainstream CE	2,742	98	3.6	2,986	(27)	(27)	(0.9)
Digital Networks	80	(3)	(3.8)	204	(46)	(45)	(22.1)
Licenses	63	35	55.6	78	66	66	84.6
	2,885	130	4.5	3,268	(7)	(6)	(0.2)
DAP	782	183	23.4	782	143	146	18.7
Components	743	(226)	(30.4)	650	(139)	(138)	(21.2)
Semiconductors	1,112	(312)	(28.1)	1,073	(292)	(279)	(26.0)
Medical Systems	1,890	239	12.6	1,916	(129)	(100)	(5.2)
Miscellaneous	512	(55)	(10.7)	487	(138)	(137)	(28.1)
Unallocated		(95)			(38)	(37)	
Total	9,226	47		9,534	(458)	(407)	
Intersegment revenues	(303)			(272)			
<b>Sales</b>	<b>8,923</b>			9,262			
<b>Income from operations as a % of sales</b>			<b>0.5</b>		(4.9)		(4.4)

\* For the sake of comparison with 2002, income from operations 2001 is also reported before amortization of goodwill.

## Product sectors (continued)

all amounts in millions of euros unless otherwise stated

### Segment revenues and income from operations

	January to December						
	2002			2001			
	segment revenues	Income (loss) from operations		segment revenues	Income (loss) from operations*		
	amount	as % of segment revenues		US GAAP basis	before amortization goodwill	as % of segment revenues	
Lighting	4,873	602	12.4	5,122	582	590	11.5
Consumer Electronics:							
Mainstream CE	9,081	113	1.2	10,071	(671)	(671)	(6.7)
Digital Networks	320	(71)	(22.2)	771	(329)	(328)	(42.5)
Licenses	268	188	70.1	391	351	351	89.8
	9,669	230	2.4	11,233	(649)	(648)	(5.8)
DAP	2,294	401	17.5	2,246	334	346	15.4
Components	2,450	(329)	(13.4)	3,705	(667)	(666)	(18.0)
Semiconductors	4,613	(537)	(11.6)	4,940	(607)	(558)	(11.3)
Medical Systems	6,855	309	4.5	4,836	(163)	(59)	(1.2)
Miscellaneous	2,399	74	3.1	2,154	(104)	(101)	(4.7)
Unallocated		(330)			(121)	(119)	
Total	33,153	420		34,236	(1,395)	(1,215)	
Intersegment revenues	(1,333)			(1,897)			
<b>Sales</b>	<b>31,820</b>			32,339			
<b>Income from operations as a % of sales</b>			<b>1.3</b>		(4.3)		(3.8)

\* For the sake of comparison with 2002, income from operations 2001 is also reported before amortization of goodwill.

## Product sectors and main countries

all amounts in millions of euros unless otherwise stated

### Sales and total assets

	<b>Sales (to third parties)</b>		<b>Total assets</b>	
	January to December <b>2002</b>	2001	<b>Dec. 31, 2002</b>	Dec. 31, 2001
Lighting	<b>4,845</b>	5,083	<b>2,608</b>	2,936
Consumer Electronics	<b>9,600</b>	11,052	<b>2,553</b>	3,429
DAP	<b>2,273</b>	2,224	<b>961</b>	1,084
Components	<b>2,212</b>	2,772	<b>3,799</b>	4,193
Semiconductors	<b>4,089</b>	4,389	<b>6,898</b>	8,329
Medical Systems	<b>6,844</b>	4,834	<b>6,780</b>	7,962
Miscellaneous	<b>1,957</b>	1,985	<b>1,862</b>	2,734
Unallocated			<b>6,828</b>	8,535
<b>Total</b>	<b>31,820</b>	32,339	<b>32,289</b>	39,202

### Sales and long-lived assets

	<b>Sales (to third parties)</b>		<b>Long-lived assets *</b>	
	January to December <b>2002</b>	2001	<b>Dec. 31, 2002</b>	Dec. 31, 2001
Netherlands	<b>1,507</b>	1,555	<b>1,596</b>	1,767
United States	<b>9,409</b>	8,901	<b>5,633</b>	6,838
Germany	<b>2,333</b>	2,648	<b>664</b>	711
France	<b>1,893</b>	1,990	<b>426</b>	377
United Kingdom	<b>1,503</b>	1,560	<b>293</b>	210
China	<b>2,510</b>	2,205	<b>378</b>	523
Other countries	<b>12,665</b>	13,480	<b>2,081</b>	2,813
<b>Total</b>	<b>31,820</b>	32,339	<b>11,071</b>	13,239

\* Includes property, plant and equipment and intangible assets-net.

## Philips quarterly statistics

all amounts in millions of euros unless otherwise stated; percentage increases always in relation to the corresponding period of previous year

2001 2002

	2001				2002			
	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter
Sales	8,208	7,682	7,187	9,262	7,598	7,986	7,313	8,923
% increase	(1)	(16)	(23)	(16)	(7)	4	2	(4)
Income (loss) from operations before amortization goodwill	358	(704)	(462)	(407)	73	165	135	47
as % of sales	4.4	(9.2)	(6.4)	(4.4)	1.0	2.1	1.8	0.5
% increase	.	.	.	.	(80)	.	.	.
Income (loss) from operations as % of sales	313	(745)	(505)	(458)	73	165	135	47
% increase	3.8	(9.7)	(7.0)	(4.9)	1.0	2.1	1.8	0.5
% increase	.	.	.	.	(77)	.	.	.
Net income (loss)	93	(770)	(736)	(1,062)	9	(1,355)	(330)	(1,530)
% increase	.	.	.	.	(90)	.	.	.
per common share in euros	0.07	(0.60)	(0.57)	(0.84)	0.01	(1.07)	(0.25)	(1.20)
	January- March	January- June	January- September	January- December	January- March	January- June	January- September	January- December
Sales	8,208	15,890	23,077	32,339	7,598	15,584	22,897	31,820
% increase	(1)	(9)	(14)	(15)	(7)	(2)	(1)	(2)
Income (loss) from operations before amortization goodwill	358	(346)	(808)	(1,215)	73	238	373	420
as % of sales	4.4	(2.2)	(3.5)	(3.8)	1.0	1.5	1.6	1.3
% increase	.	.	.	.	(80)	.	.	.
Income (loss) from operations as % of sales	313	(432)	(937)	(1,395)	73	238	373	420
% increase	3.8	(2.7)	(4.1)	(4.3)	1.0	1.5	1.6	1.3
% increase	.	.	.	.	(77)	.	.	.
as a % of net operating capital (RONA)	10.9	(6.9)	(9.3)	(9.3)	2.0	3.4	3.8	3.2
Net income (loss)	93	(677)	(1,413)	(2,475)	9	(1,346)	(1,676)	(3,206)
% increase	.	.	.	.	(90)	.	.	.
as a % of stockholders' equity (ROE)	2.1	(7.1)	(9.8)	(11.9)	0.2	(14.7)	(13.3)	(19.2)
per common share in euros	0.07	(0.53)	(1.10)	(1.94)	0.01	(1.06)	(1.31)	(2.51)
	period ending 2001				period ending 2002			
Inventories as % of sales	15.6	16.0	14.9	13.3	14.0	13.4	14.1	11.1
Average collection period of trade receivables in months' sales	1.6	1.7	1.7	1.5	1.7	1.6	1.6	1.3
Net debt : group equity ratio	17:83	20:80	27:73	26:74	28:72	30:70	30:70	27:73
Total employees (in thousands)	219	212	192	189	186	184	183	170

Information also available on Internet, address: [www.investor.philips.com](http://www.investor.philips.com)

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