
Company Monitor

Royal Philips Electronics N.V.

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somo

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1. General data

Name:	Koninklijke Philips Electronics N.V. (Royal Philips Electronics)
Registered office:	Eindhoven
Business Address:	Breitner Center, HBT 12-8 Amsterlplein 2 P.O. Box 77900 1070 MX Amsterdam The Netherlands
Internet:	www.philips.com
Stock market symbol:	PHG
Logo:	

1.1. Main activities

Royal Philips Electronics of the Netherlands is one of the world's biggest electronics companies and Europe's largest. It is a global leader in colour television sets, lighting, electric shavers, medical diagnostic imaging and patient monitoring, and one-chip TV products.

1.2. Position in the market¹

(Value based, 2002)	World	Europe	APAC*
Lighting	1	1	1
Consumer Electronics	3	2	4
Medical Systems	2	1	2
Monitors (branded)	5	3	3
Shavers	1	1	1
Steam irons	2	2	1
Semiconductors	9	6	5
Colour picture tubes	3	1	11
DVD recorders	1	1	1
Mobile Display Systems	2	2	-
Dental care (electric toothbrushes)	2	2	2

* Asia Pacific region excl. Japan

¹ Cf. <http://www.philips.com/assets/Downloadablefile/final-pdf-SAR-2003-12989.pdf> (12 December 2004), p. 9.

2. Production

2.1. Net sales and income of operations

In millions of €

	1997	1998	1999	2000	2001	2002	2003 ²
Net sales ³	29.658	30.459	31.459	37.862	32.339	31.820	29.037
Income of operations ⁴	1.714	1.289	1.553	4.258	-1.395	420	488
Net Income ⁵	2.602	6.053	1.590	9.662	-2.475	-3.206	695

2.2. Product Divisions

In June 2003, Philips Electronics had five product divisions⁶:

- Lighting;
- Consumer Electronics;
- Domestic Appliances and Personal Care;
- Semiconductors and;
- Medical Systems.

In 1996 Philips had 12 product divisions, whereas in 2000 there were only six product divisions left. This number was further reduced to five divisions in 2003.

2.3. Division Sales

In millions of €

	1997	1998	1999	2000	2001	2002	2003 ⁷
Lighting	4.549	4.453	4.548	5.052	5.083	4.845	4.522
Consumer Electronics	11.465	12.364	12.436	13.060	11.052	9.600	9.188
DAP	-	1.746	1.791	2.107	2.224	2.273	2.131
Components	3.664	3.814	3.754	5.042	2.772	2.212	-
Semiconductors	3.144	3.212	3.796	5.879	4.389	4.089	4.988
Professional	4.301	-	-	-	-	-	-
Medical Systems	-	1.950	2.493	3.031	4.834	6.844	5.990
Origin	846	1.059	1.056	717	-	-	-
Miscellaneous	1.689	1.861	1.585	2.974	1.985	1.957	2.218
Total	29.658	30.459	31.459	37.862	32.339	31,820	29.037

² <http://www.philips.com/assets/Downloadablefile/final-pdf-SAR-2003-12989.pdf> (12 December 2004), p. 57.

³ Net sales: gross sales minus returns, discounts, and allowances.

⁴ Income from operations is the profit realised from a business' own operations.

⁵ Net income: gross sales minus taxes, interest, depreciation, and other expenses. Net income can also be called net profit, net earnings or bottom line.

⁶ The division Components was dissolved in 2002.

⁷ <http://www.philips.com/assets/Downloadablefile/final-pdf-SAR-2003-12989.pdf> (12 December 2004), p. 55.

2.4. Income of operations per division

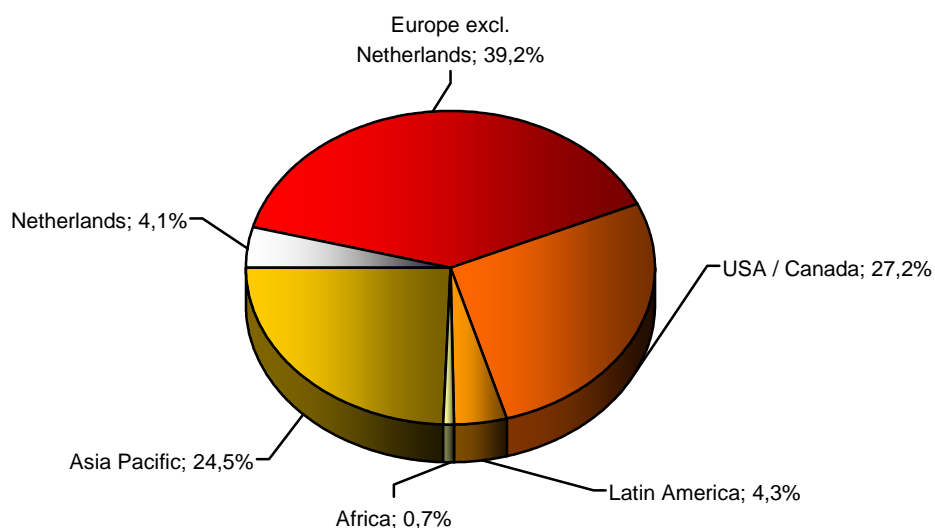
In millions of €⁸

	1997	1998	1999	2000	2001	2002	2003
Lighting	522	595	602	668	623	602	577
Consumer Electronics	335	-447	258	410	-649	230	248
DAP	-	199	220	287	334	401	398
Components	255	44	286	608	-667	-329	-
Semiconductors	771	765	614	1.346	-607	-537	-342
Professional	207	-	-	-	-	-	-
Medical Systems	-	-49	181	169	-199	309	431
Origin	-	59	97	1.063	-	-	-
Miscellaneous	14	-82	-94	-191	-104	74	-263
Unallocated	-390	-399	-413	-79	-102	-330	-561
Total	1.714	685*	1.751	4.281	-1.371	420	488

* According to US reporting methods this figure is 1.289, see also the figure in table "Net sales and operational income" on page 6.

2.5. Net sales by geographic area in 2003

As a % of total⁹

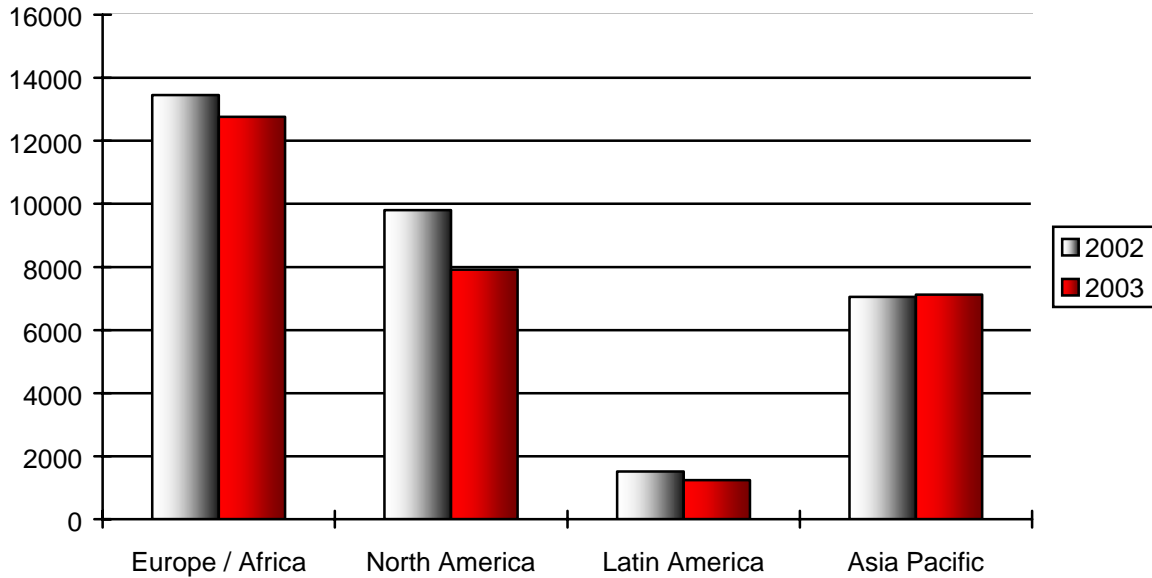


⁸ http://www.investor.philips.com/reports/03_AR_i/fig_det/dataprod.html (12 December 2004).

⁹ <http://www.philips.com/assets/Downloadablefile/final-pdf-SAR-2003-12989.pdf> (12 December 2004), p. 55.

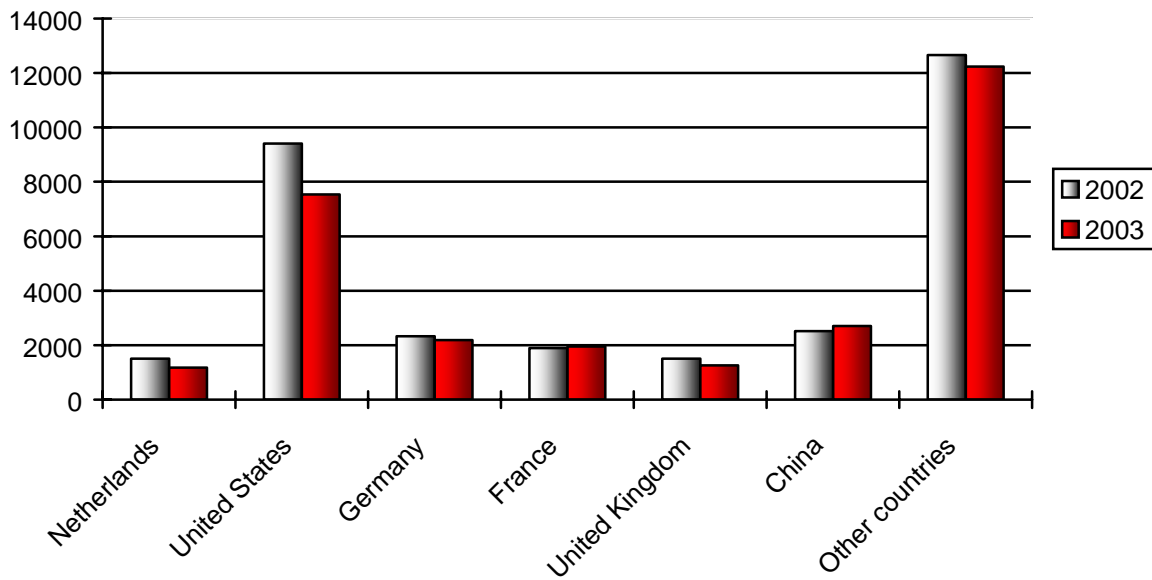
2.6. Sales per geographic area in 2002 and 2003

In millions of €¹⁰



2.7. Sales in main countries, 2002 and 2003

In millions of €¹¹



¹⁰ http://www.investor.philips.com/reports/03_AR_i/performance_region.html (12 December 2004).

¹¹ http://www.investor.philips.com/reports/03_AR_i/fig_det/datageog.html (12 December 2004).

3. Production and employment

3.1. Manufacturing sites

Region	Number of sites 1998	Number of sites 2000	Number of sites in 2003
USA and Canada	51	34	
South America	18	21	
Europe	122	100	
Australia	4	1	
Asia	74	47	
Total World	269	203	135

Western Europe	Americas	Eastern Europe	Asia & Oceania	Africa & Middle East
Austria	United States	Belarus	Australia	Egypt
Belgium	Brazil	Bosnia and Herzegovina	Azerbaijan	Morocco
Denmark	Canada	Bulgaria	China	South Africa
Finland	Chile	Croatia	Hong Kong	Zambia
France	Colombia	Czech Republic	India	Zimbabwe
Germany	Ecuador	Estonia	Indonesia	
Greece	El Salvador	Hungary	Iran	
Ireland	Mexico	Latvia	Japan	
Italy	Dutch Antilles	Lithuania	Kazakhstan	
Luxembourg	Paraguay	Poland	Kyrgyzstan	
The Netherlands	Peru	Romania	Malaysia	
Norway	Uruguay	Russia	New Zealand	
Portugal	Venezuela	Slovakia	Pakistan	
Spain		Slovenia	Philippines	
Sweden		Turkey	Singapore	
Switzerland		Ukraine	South Korea	
United Kingdom		Yugoslavia	Taiwan	
			Thailand	
			United Arab Emirates	
			Uzbekistan	

3.2. Employment

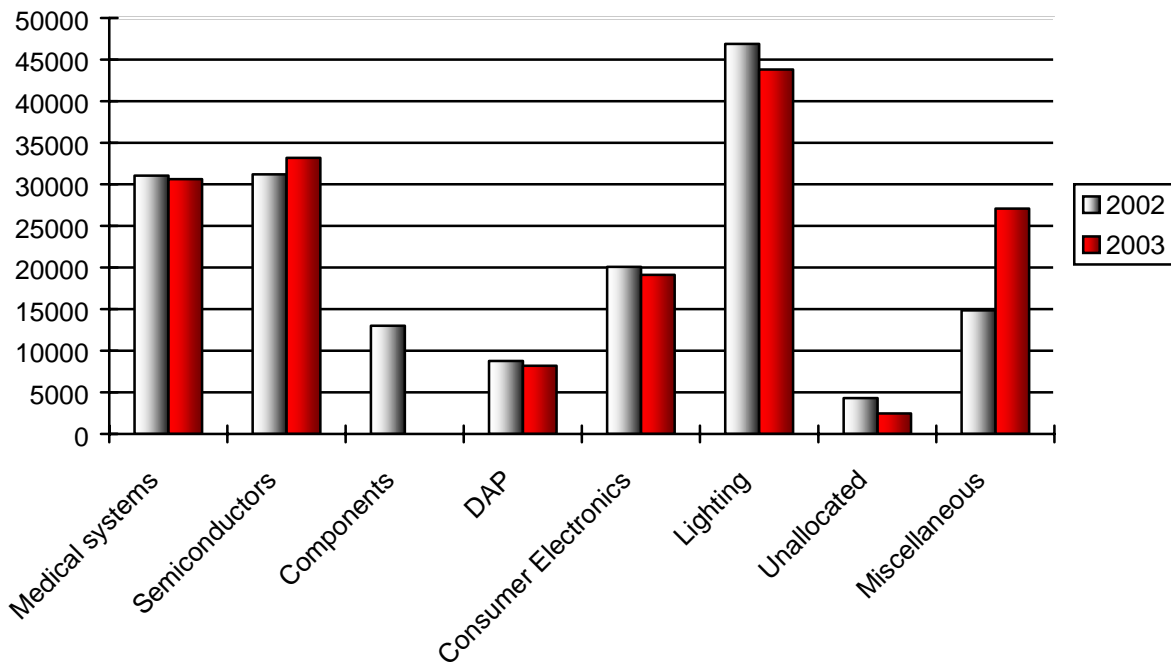
2002

The number of employees at the end of December 2002 totalled 170.087, a decline of 18.556 from December 31, 2001. Part of the reduction (9.514) was caused by consolidation changes. Excluding these changes, the headcount reduction came to 9.042, mainly centred on Consumer Electronics, Semiconductors and Corporate Investments. The headcount at Medical Systems increased by 846 employees as a result of expansion of the business. In geographical terms, Europe and Asia Pacific accounted for most of the decrease. The headcount reduction was most significant in the production and general administrative areas, while the Research and Development area was less affected.

2003

In 2003, the total number of Philips' employees was 164.438. These employees were active in the areas of lighting, consumer electronics, domestic appliances, semiconductors and medical systems.

Employees by sector at year-end 2002 and 2003¹²



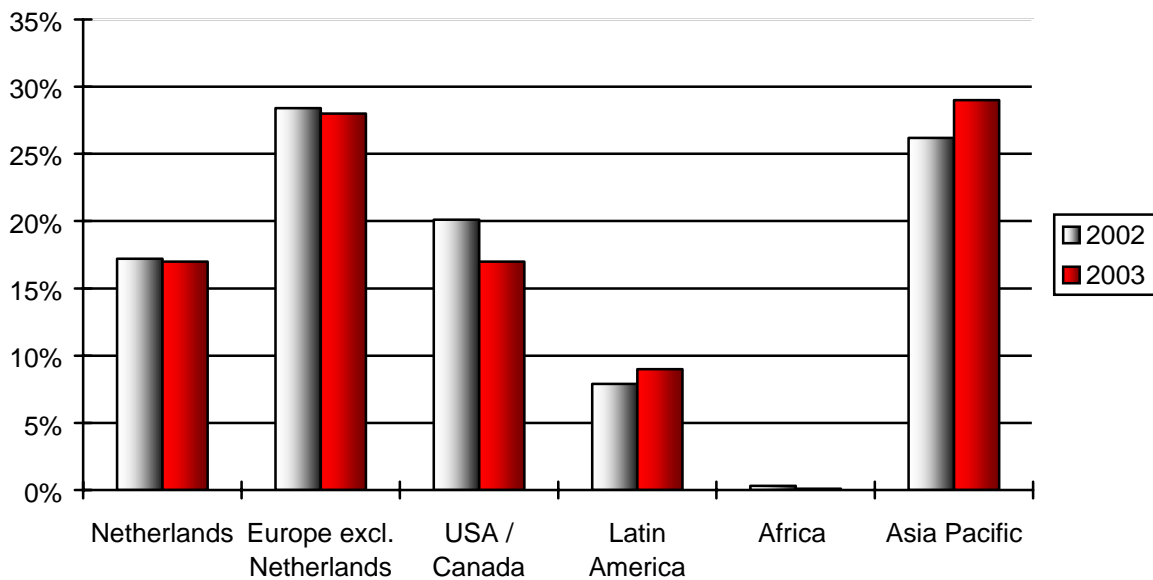
The geographic spread of employees reflects the company's business expansion into the USA / Canada and Asia Pacific. With the rapidly expanding activities of Medical Systems, the number of employees in the USA surpassed the Netherlands in 2002. In functional terms, the business activities (production, research and development, sales etc.) are widely distributed across the main geographic areas. The decrease of employment levels in 2002 and 2003 was most significant in the areas 'production' and 'general', while research & development was less affected. In 2002 and

¹² Philips's sustainability reports over 2002 and 2003.

2003, the number of employees with a temporary contract increased as a result of “uncertain and unfavourable market conditions” and the “need for flexibility”.¹³

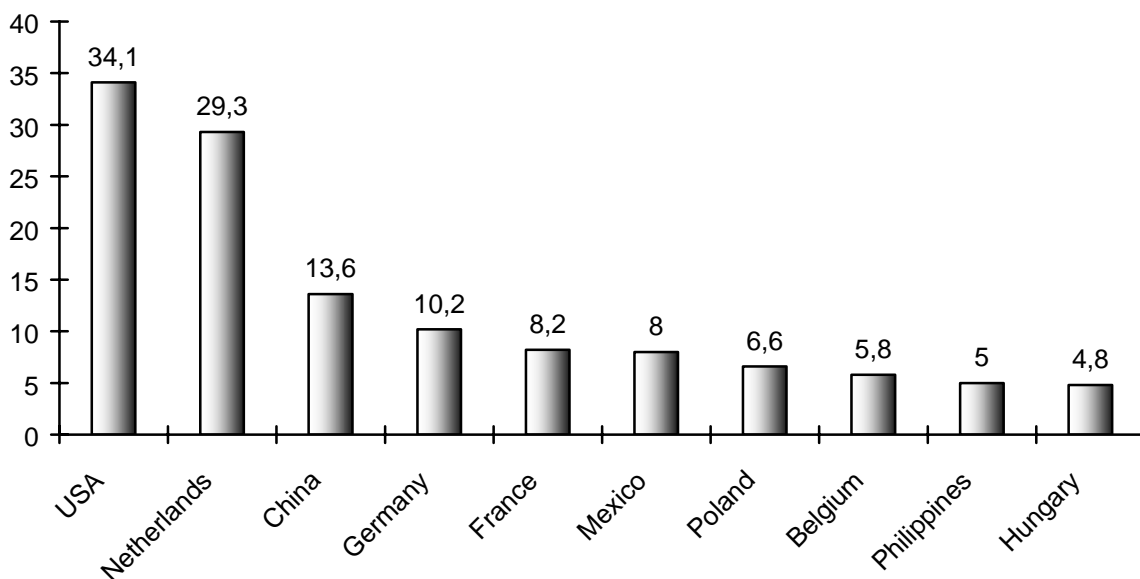
3.3. Employees by geographic area at year-end 2002 and 2003¹⁴

As a % of total



3.4. Philips employees in main countries at year-end 2002

Number of FTE's in thousands

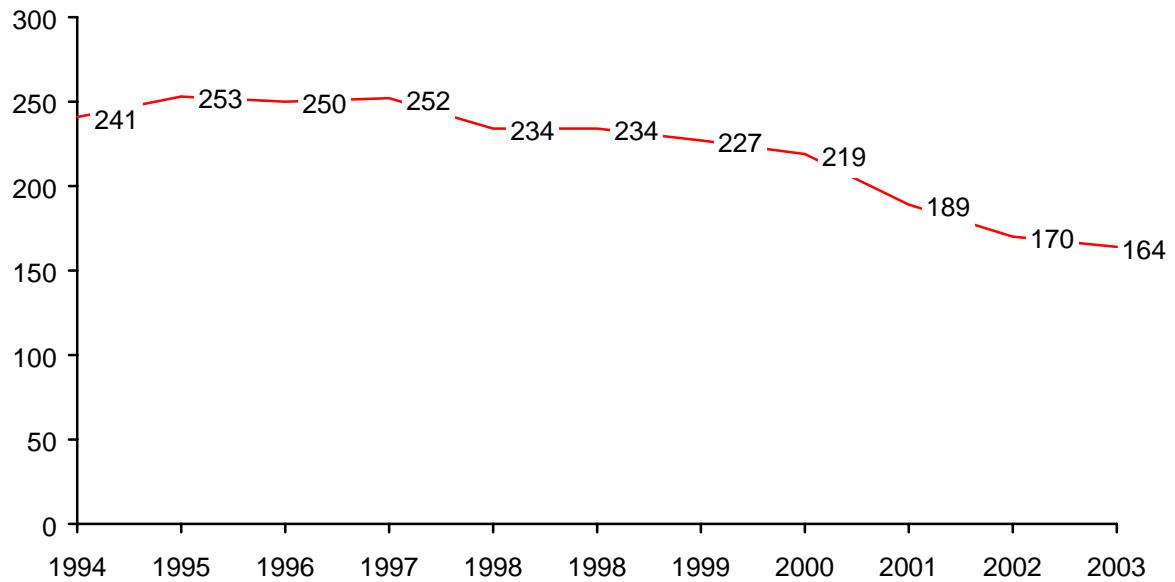


¹³ Sustainability report 2002.

¹⁴ Philips's sustainability reports over 2002 and 2003.

3.5. Total number of Philips employees in the last ten years

In thousands¹⁵



3.6. Key employees

Name	Level
Gerard J. Kleisterlee	President and Chief Executive Officer (Since: 2001)
Jan H. Hommen	Executive Vice President
Gottfried Dutiné	Executive Vice President
Ad Huijser	Executive Vice President and Chief Technology Officer
Arie Westerlaken	Senior Vice President and Chief Legal Officer

¹⁵ http://www.investor.philips.com/reports/03_AR_i/fig_det/tenyear.html (12 December 2004)

4. Strategy

4.1. History

The foundations of Philips were laid in 1891 when Gerard Philips established a company in Eindhoven, the Netherlands, to “manufacture incandescent lamps and other electrical products”. The company initially concentrated on making carbon-filament lamps and by the turn of the century was one of the largest producers in Europe. Developments in new lighting technologies fuelled a steady program of expansion, and, in 1914, it established a research laboratory to study physical and chemical phenomena, so as to further stimulate product innovation.

Marketing companies had already been established in the US and France before the First World War, and in Belgium in 1919, and the 1920s saw an explosion in their number. It was at this time that Philips began to protect innovations with patents, for areas taking in X-ray radiation and radio reception. This marked the beginning of the diversification of its product range. Having introduced a medical X-ray tube in 1918, Philips then became involved in the first experiments in television in 1925. It began producing radios in 1927 and had sold one million by 1932. One year later, it produced its 100-millionth radio valve, and also started production of medical X-ray equipment in the United States. Philips' first electric shaver was launched in 1939, at which time the company employed 45.000 people worldwide and had sales of 152 million guilders.

Science and technology underwent tremendous development in the 1940s and 1950s, with Philips Research inventing the rotary heads which led to the development of the Philishave electric shaver, and laying down the basis for later ground-breaking work on transistors and integrated circuits. In the 1960s, this resulted in important discoveries such as CCDs (charge-coupled devices) and LOCOS (local oxidation of silicon).

Philips also made major contributions in the development of the recording, transmission and reproduction of television pictures, its research work leading to the development of the Plumbicon TV camera tube and improved phosphors for better picture quality. It introduced the Compact Audiocassette in 1963 and produced its first integrated circuits in 1965. The flow of new products and ideas continued throughout the 1970s: research in lighting contributed to the new PL and SL energy-saving lamps; other key breakthroughs came in the processing, storage and transmission of images, sound and data where Philips Research made breakthroughs, resulting in the inventions of the LaserVision optical disc, the Compact Disc and optical telecommunication systems.

Philips established PolyGram in 1972, and acquired Magnavox (1974) and Signetics (1975) in the United States. Acquisitions in the 1980s included the television business of GTE Sylvania (1981) and the lamps business of Westinghouse (1983). The Compact Disc was launched in 1983, while other landmarks were the production of Philips' 100-millionth TV set in 1984 and 300-millionth Philishave electric shaver in 1995.

The 1990s was a decade of significant change for Philips. Throughout this decade, a number of important reorganisations took place, the most notable being “Operation Centurion”, which involved some 10.000 predominantly blue-collar workers in The Netherlands. Despite the decline of

production and assembly activities, the majority of the Dutch workforce still consists of blue-collar employees.¹⁶

4.2. Current corporate strategy

During the last years, Philips has been reducing the amount of production sites. In 1997 Philips took the decision to reallocate and to concentrate its activities. Compared to its competitors, Philips had too many and relatively small production facilities. The reduction of production sites led to a substantial decline in personnel (265.000 in 1995 to 227.000 in 1999, to 164.000 in 2003).

Having reduced the number of divisions to five, with the dismantling of its components unit in 2002, Mr Kleisterlee unveiled in January 2003 a three-pronged strategy focused on healthcare, consumer lifestyle products and enabling technologies, such as semiconductors. Additionally, Philips continues to weed out non-core activities within its five business lines: consumer electronics, medical systems, lighting, semiconductors and domestic appliances.

The cost reduction program is focused on reducing the overhead costs and the restructuring program will be continued in 2005. Philips' CEO describes this program as: "simplifying our organisational structure and submitting many processes to the test of common sense."¹⁷ In 2004, a new brand campaign was launched under the name "Sense and Simplicity".

4.3. Shareholder value

Since 1996, when Cor Boonstra assumed the post of CEO, shareholder value has been a major issue in Philips' strategy. To Philips, shareholder value means:

- Independent Lines of Business (LoB)
- Only investments in strategic activities
- Overall target of 24% Return on Net Assets (Rona)¹⁸
- Restructuring of production strategy:
 - Reduction of in-house production of components
 - production in joint ventures
 - production in low cost countries
- Less costs of central overhead

This resulted in reducing the number of product divisions from 12 to 5 in 2004. Also, progressive outsourcing takes place.

More than 40% of the shares are in American hands and 15 % in British hands. The predominance of American and British shareholders has led Philips to choose for the Anglo-American model for corporate governance.

¹⁶ Marc van der Meer et al., The impact of globalisation on Industrial Relations in Multinationals in the Netherlands (Amsterdam: Stichting FNV Pers, 2004), p.42.

¹⁷ <http://www.newscenter.philips.com/About/article-14516.html> (13 December 2004)

¹⁸ Rona: a performance measure for tracking and achieving cost control; an examination of net earnings in relationship to the net assets that are invested to generate them. Net assets plus non-interest bearing liabilities are a part of the measure.

As of December 31, 2003, no person is known to the company to be the owner of more than 5% of its Common Shares. The Common Shares are held by shareholders worldwide in bearer and registered form. Outside the United States, shares are held primarily in bearer form. As of December 31, 2003, approximately 88% of the common shares were held in bearer form. In the United States shares are held primarily in the form of registered shares of New York Registry (Shares of New York Registry). As of December 31, 2003, approximately 12% of the total number of outstanding common shares were represented by Shares of New York Registry issued in the name of approximately 1,500 holders of record, including Cede & Co, acting as nominee for the Depository Trust Company holding the shares (indirectly) for individual investors as beneficiaries.¹⁹

4.4. Geographical concentration

Philips divides the world in three regions:

- North America and Mexico
- Western Europe and Eastern Europe
- Asia - Pacific and South Korea / China

For most important products there are development centres, production sites, sales offices and "border zones" for cheap labour in each region. Philips has shifted research and development on most televisions, cell phones, and audio products to Shanghai. In 2002, 20% of the total production of Philips came from China.

4.5. Low-wage countries or "cost-competitive locations"

The "One Philips" concept, launched in 2002, has high costs. Some 89.000 jobs have been shed since 1995, or 35% of Philips' workforce, either through plant closures, divestments or outsourcing. That process continues, with electronics assembly work shifted from costly western European sites to central America, the Far East and Eastern Europe either through outsourcing production to a new owner or by relocating to factories where labour costs are lower. It is, Mr. Kleisterlee said, a "*fact of life for a traditional company*" and one that will come as no surprise internally. "*We have talked about it. People know it has to happen.*"²⁰

Some parts of China, for instance Shanghai and Beijing, are already getting too expensive.²¹ Therefore, Philips is already transferring part of its production sites to cities in the west of China.²²

4.6. Recent relocations

¹⁹ http://www.investor.philips.com/reports/03_AR_i/governance.html (16 December 2004).

²⁰ Financial Times, London Edition 1, 8 January 2003.

²¹ "Philips' jagelonen caroussel," De Volkskrant, 4 March 2003.

²² Gert-Jan van Teeffelen, "De nieuwe werkplaats van Philips," De Volkskrant, 10 April 2004, sec. Economie, p. 25.

- July 2002: Philips closed a computer monitor plant in Mexico and the production is transferred to China. The closure affected 900 jobs. The plant's closure corresponded to the global strategy carried out by the company to reduce costs.²³
- 2003: LG Philips Displays factory in Ottawa (USA) was closed and the production moved to north central Mexico.²⁴
- 2003: LG Philips Displays, moving the production of monitors for personal computers en televisions from the Netherlands (200 jobs in Sittard and 90 jobs in Stadskanaal) to South Korea.²⁵
- January 2003: relocation of the production of CRT-monitors from Szomathely in Hungary to China, 500 jobs are affected.²⁶
- February 2003: Production of televisions relocated from Dreux (France) to Hungary. 900 jobs were affected.
- 2003: relocation of the production of high-end televisions (LCD and Plasma) from Europe to Suzhou in China.

4.7. Reduction of overhead costs

In 2002 the overhead costs were reduced by € 257 million. Corporate overhead costs continued to be aggressively reduced during 2003, offset by a large increase in pension costs. Pension costs increased by € 256 million in 2003, and include postretirement benefit costs relating to inactive employees, which are not attributable to the product divisions.

4.8. Restructuring programs in 2002, 2003 and 2004

The most significant restructuring and impairment charges in 2002 were related to:

- The dissolution of the Components division (€ 78 million);
- Rationalization of the product portfolio of Optical Storage (€ 104 million);
- Reduction of excess capacity at Semiconductors (€ 180 million);
- Reduction of PCMS²⁷ manufacturing capacity at Louviers, Juarez and Hasselt (€ 96 million);
- Several programs at Lighting in the Netherlands (€ 20 million);
- Closure of Monitors' production facilities in Mexico (€ 11 million);
- Reduction of Research activities (€ 12 million);
- HCP²⁸ asset and goodwill impairment (€ 47 million).

The future annual savings from the above restructurings were estimated at approximately € 325 million.

For the year 2003 the agenda was to:

²³ "Philips to close computer monitor plant in Mexico", El Economista, 1 July 2002.

²⁴ "Workers lose jobs at Ottawa, Ohio, LG philips Flat-panel television supplier," The Lima News, 7 January 2003.

²⁵ "Philips snijdt in productie beeldbuizen," Het Financieele Dagblad, 10 January 2003.

²⁶ "Philips verhuist van Hongarije naar China," NRC Handelsblad, 14 January 2003.

²⁷ PCMS: Philips Contract Manufacturing Services.

²⁸ HCP: Healthcare Products Group. This group in the US was sold to the Platinum Equity Holding in 2002.

- Complete the TOP (“Towards one Philips”) program;
- Achieve the cost-saving target of € 1 billion;
- Restore Semiconductors to profitability by lowering the break-even point;
- Bring Consumer Electronics in the USA to full profitability from the fourth quarter onward;
- Move Medical Systems forward to achieve 14% EBITA²⁹ in 2004;
- Make Philips a truly market-driven company.

In 2003, Philips even exceeded its target of saving € 1 billion by the end of the year. During 2003 Philips actually achieved additional consolidated savings of € 486 million. The savings were realized through a reduction in overhead costs, post-merger integration savings at Medical Systems, and other initiatives designed to lower Philips’ cost base, e.g. in the fields of non-product-related purchasing and Research and Development.

Restoring Semiconductors to profitability delivered on all points of its improvement plan, resulting in an 11% operating margin in the fourth quarter. In the words of Philips president, Mr Gerard Kleisterlee, “Capacity was rationalized”, primarily through the closure of the company’s older production facilities in San Antonio and Albuquerque. R&D efforts have been focused on connected consumer applications, structures simplified and throughput times reduced.

In the United States, Philips operations managed to reach break-even in the fourth quarter of 2003, while taking additional measures to further lower the cost base for 2004. On a global level Consumer Electronics has in recent years continually lowered its risk exposure and reduced costs. As a result, Philips expects to be able to achieve further annual savings of € 400 million within two years by executing a business renewal program. On the revenue side Philips is focusing on winning market share in key categories, with leading-edge products such as Flat TV and DVD+RW.

Medical Systems progressed according to plan, realizing “synergy benefits” of almost € 350 million. In 2004, income from operations increased by 39% to € 431 million; on track for Philips’ EBITA objective of 14%. Having completed the imaging portfolio with the recent acquisitions, the focus over the coming years will shift to expanding customer services and healthcare IT while developing new initiatives in the areas of personal healthcare and molecular medicine. An important step in 2003 was the alliance with Epic Systems Corporation to provide enterprise software, medical imaging and monitoring IT solutions that integrate patient information enterprise-wide.

Philips’ objective of transforming the corporation into a truly market-driven company involves an “ongoing effort to build strong customer intimacy across the entire organization, develop a superior brand strategy and foster best-in-class marketing competencies to drive profitable growth”. Specific branding plans have been formulated for the US and China to strengthen awareness and preference for Philips. The company also consolidated to one advertising agency to enhance consistent delivery.

Reflecting the opportunities and ambitions outlined before, Philips has set itself clear goals for the coming years. From a financial perspective the company will consistently earn returns in excess of its cost of capital. For Philips this has been more the exception than the rule, and this must change. Also, Philips will improve the profitability of its portfolio to 7 to 10% operating margin within the period from 2006 to 2007.

²⁹ EBITA: Earnings Before Interest Taxes and Amortization.

Philips plans to do this by re-allocating capital towards opportunities that offer higher rates of return and by improving productivity through the pursuit of operational excellence and ongoing business transformation. Philips says it will continue to leverage its brand and core competencies in healthcare, lifestyle and technology while building partnerships with key customers to achieve growth. And in order to sustain this growth in the longer term, Philips will continue to invest in its R&D infrastructure and further capitalize upon its strong position in the field of intellectual property.

Consistent with its Long-Term Incentive Plan, Philips continues to target a Total Shareholder Return (TSR)³⁰ that is in the top quintile of its defined peer group of 24 companies.

With these objectives in mind, the company plans to execute the following management agenda for the year 2004:

- Achieve 14% EBITA at Medical Systems;
- Implement a Consumer Electronics' renewal program;
- To achieve stable 4 - 4,5% operating margin³¹ by the end of 2005;
- Accelerate profitable growth through the sustained transformation of Philips into a market-driven organisation;
- Increase the number of product leadership positions and the innovation rate across the company;
- Continue to focus on indirect cost to achieve additional savings of € 250 million.

4.9. Overview of investments and divestments

Since 1977, Philips has invested increasingly in product development. Over the years, a number of strategic acquisitions have been made:

1998	ATL Ultrasound	USA	Medical Systems
1999	Micrion / FEI	USA	Semiconductors
1999	LG LCD 50%	South Korea	Components
1999	VLSI	USA	Semiconductors
1999	Voice Control Systems	USA	PCE
2000	ADAC Laboratories	USA	Medical Systems
2000	MedQuist	USA	Medical Systems
2000	Health Care Solutions	USA	Medical Systems
2000	MiCRUS	USA	Semiconductors
2000	Optiva Corporation	USA	DAP
2000	LG Display 50%	South Korea	Display Comp.
2000	LG Electronics 15%	South Korea	Philips

³⁰ Total Shareholder Return (TSR): the overall return enjoyed by investors, including dividend and capital appreciation, expressed as a percentage of their initial investment. Related to individual years, or to a lengthier time period, and then converted into an annualised, or equivalent annual return.

³¹ Operating Margin: The key measure of profitability and performance is a company's operating margin. The operating margin is determined by subtracting the operating expenses from the total revenues and then dividing that result by the total revenue. One time gains and losses, interest expenses, interest income, other income, and taxes are excluded from the operating margin.

2001	Marconi Medical Sys.	USA	Medical Systems
2001	Agilent's Healthcare Sol.	USA	Medical Systems
2001	Grupo Axa (Luministas)	Mexico	Lighting
2003	Closure of Chip Plant	USA	Consumer Electronics
2004	Transfer of the production of low-end monitors and televisions to TPV (Taiwan), in exchange for a 15 % stake in TPV.	Taiwan	Consumer Electronics

4.10. Global strategic partnerships

Philips has unveiled several global strategic partnerships to bring product relevance to new or local markets as well as to establish distribution channels to reach new Philips consumers. Here are some examples:

- May 2003: Philips formed a development, manufacturing, and customer alliance with Mapper Lithography B.V., a Dutch-based lithography-tool start-up;
- May 2003: Philips and Visa International today announced a major alliance to jointly promote and develop the application of contact less chip technology for payment transactions;
- April 2003: Philips enters furniture industry with Cappellini;
- March 2003: An alliance between Philips and KPN to jointly develop the use of broadband and associated enabling technologies in the Connected Home.

4.11. Strategy for Asia

In the forthcoming years, Philips will focus on growth markets in Asia and in particular China. As early as 2006, Asia will account for almost 40% of the market that is relevant to Philips. That is why Philips' Board of Management made lengthy collective working visits to India and China in 2003: to get a detailed idea of its position, its opportunities and the associated challenges and risks.

Philips plans to build on its leadership in the Asia Pacific region by focussing on three critical areas:

1) Localisation:

- *Local Products for Local People* - Philips has developed products for the Asian market based on consumer's needs. Philips estimates that within 10 years, over 30 percent of Philips' sales will come from Asia. Therefore, it seems to make sense to localise products and services.
- *Local talent* - Another aspect of Philips' policy for localisation has to do with employing in-country managers and in-country talent. For example, nearly a 100 percent of Philips' employees in India are local.
- *Local Presence* - Philips says it invests in the local community and the "culture" of each market, supporting everything from sports to educational scholarships to art and music.
- *Collaborating with Local Governments* - Philips wants build good relationships with local governments from the start, meeting with country leaders regularly. "We follow the rules and behave responsibly, and that has made us successful in the region." Philips states that

it values local customs and governments, and country leaders are assured that Philips is committed to creating sustainable work environments within their countries.

2) Alliances and partnerships:

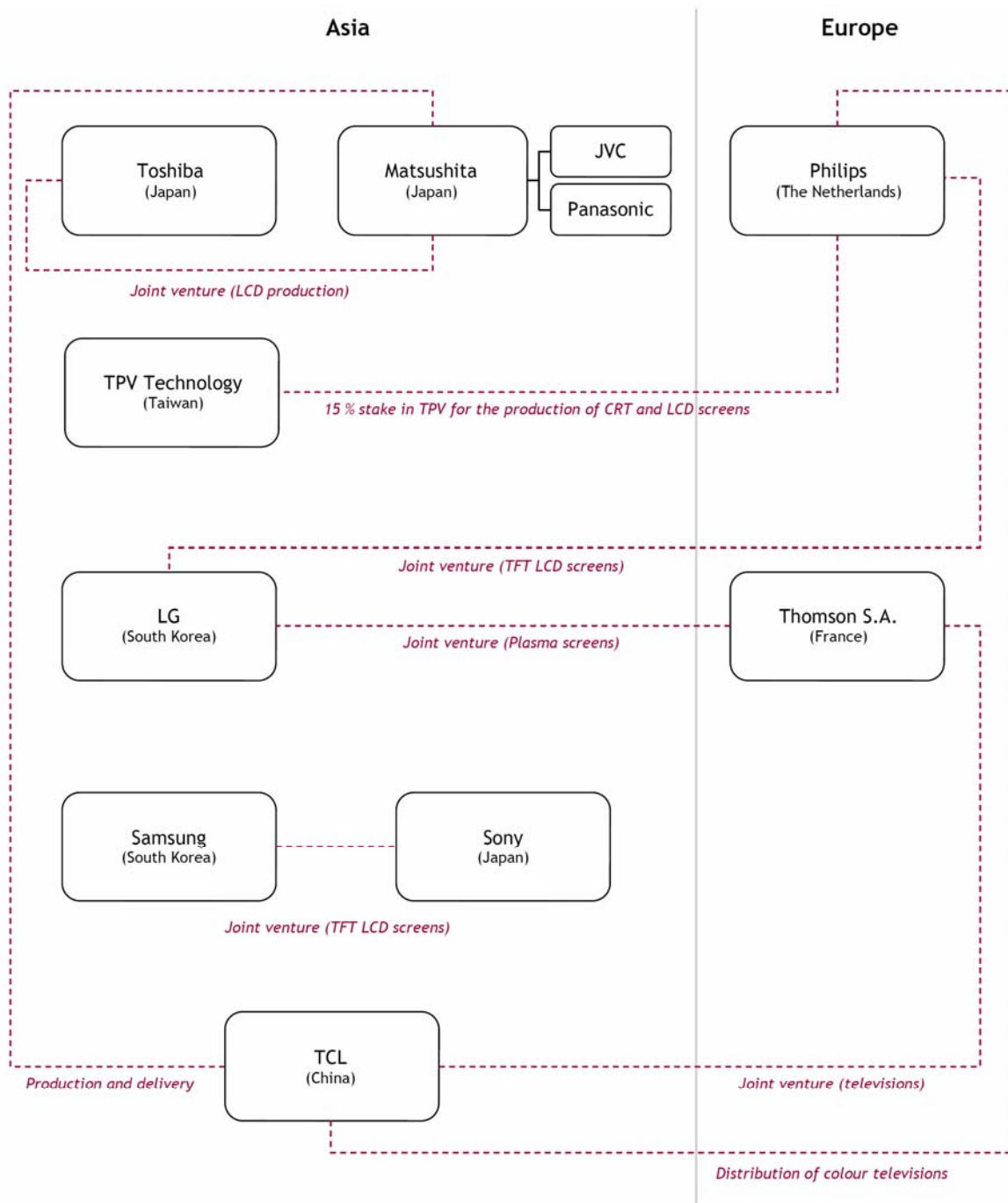
Philips has unveiled several global strategic partnerships. In 2003, in China alone, Philips had 30 joint ventures and wholly-owned companies. The company appointed TCL Group – a Chinese electronics powerhouse – as its distributor of colour televisions. The local Chinese partners help Philips to bring product relevance to the Chinese market as well as established distribution channels to reach new Philips consumers.³² Another significant partnership is LG - Philips in South Korea. While Philips is surrounded by strong local competition in South Korea, the company has remained aggressive and enjoys strong domestic market share.

3) Upleveling R & D efforts:

For Philips, the Asia Pacific region is poised for growth because many of the economies are still developing and technology has not yet saturated the region. Philips is leveraging Asia's vast intellectual capital by cultivating research and development centres in Singapore, Xian, Beijing, Hong Kong, Shanghai, Taipei and also for software in Bangalore.

³² One third of Philips' three million television screens, and half of Philips one million television sets manufactured in China are sold domestically.

An overview of Philips' strategic partnerships, joint ventures and main competitors in the electronics market in Asia



4.12. Management programs

A key element to create a more cost-effective organisation is the program *Transforming into One Philips* (TOP). It is designed to streamline business support functions by standardising processes and introducing a shared way of working in the areas of IT, Human Resource Management, Finance and Purchasing. The following actions, among others, have been undertaken to standardise processes within global Philips operations:

- Creation of an Employee Reference File (ERF). This file contains data on all Philips' employees worldwide;
- Implementation of a Long Term Incentive Plan (LTIP), which outlines the criteria for granting stock options;
- Unification of recruitment services (ERS). All recruitment procedures throughout the company are harmonised;
- Creation a uniform learning system (ELS). The aim of this Employee Learning System is to train Philips' employees throughout the world in the exact same way.³³

During a presentation at an international conference, Jeroen Terstegge, Privacy Officer and Legal Counsel of Royal Philips Electronics, outlined which areas of the company would be affected by the TOP program Philips and the process of standardisation of procedures³⁴:

- Globalisation / Regionalisation
 - Shared Service Centers
 - Global Transborder Data Networks
 - Global Purchasing Agreements
- Centralisation
 - Customer and HR Information Systems
 - Uniform Policies on Marketing and HR
- Outsourcing
 - Customer Care
 - IT

In spite of the fact that all management procedures are being standardised, no general policies are formulated with regard to the remuneration of the worldwide workforce.

To reach higher quality levels in all products and services, Philips has created a business excellence model called Business Excellence through Speed and Teamwork (BEST). The measures for this quality program are:

- Customers are fully satisfied by the quality of Philips' products and services
- Employees develop and use their full potential
- Shareholders get a premium return on their investment
- Suppliers choose to work with Philips as this generates superior value for both
- The larger community appreciates Philips' contribution to the quality of life³⁵

³³ Keynote address by Piet Verheijden (Philips), during the seminar "Globalisering op de Werkvloer", 26 November 2004.

³⁴ Presentation by Jeroen Verstegge (Philips), during the 25th International Conference on of Data Protection and Privacy Commissioners, 10 September 2003.

5. Relations with workers' representatives

5.1. Policy towards unions on a national level - recent developments

On January 30, 2004 Philips reached an agreement in principle with trade unions in The Netherlands. On March 31, 2004 the final confirmation by the trade unions was obtained with respect to the proposed changes to the Dutch pension plan. The agreement was also confirmed by the Trustees of the Philips Pension Fund. The new agreement will result in changes to the Company's pension obligations towards its current and former employees and in a more balanced distribution of pension burdens between the Company and its employees. The agreed change from a final pay to an average pay pension system in the Netherlands, which incorporates a limitation of the indexation, results in a reduction of the Company's projected benefit obligation by € 766 million effective the end of March 2004.

5.2. Policy towards unions on a international level

On an international level there are no structural consultations with the trade unions. According to Piet Verheijden, responsible within Philips for international relations with trade unions, Philips has engaged in informal talks with trade unions on an international level. These talks, however, are still in an incipient stage.³⁶

Philips tends to restrict itself to compliance with the rules and regulations within national legislations. Therefore, Philips' workers in different countries and certainly regions are treated in different ways. The IMF World Conference, held in Amsterdam in February 2001, showed this quite clearly. The need for an International platform with all unions related to Philips was uttered there, suggesting the formation of an communication bank with easy access for all interested.

5.3. European Works Council - Euroforum

The European Philips Forum (EPF) - Euroforum - was established in 1998 with the European Works Council as the highest consultation platform in the region. This group meets with Philips management twice a year to discuss business developments of significant importance to employees of the Philips Group companies in the European Union, plus Switzerland and Norway.

Topics on the 2003 agenda included an update on the company by Philips President Gerard Kleisterlee, and a discussion on the importance of having the correct procedures and mindset to deal with the employees and local communities affected by the transformation in Europe. As a result of the dialogue, a company position paper was written: "Responsible Transformation within Europe". The EPF has not signed the document, but considers it a step forward, although it is still rather vague according to EPF.³⁷

³⁵ Herbert de Kort, BEST in Philips Electronics: the experience of a pan European company, <http://www.asq.org/members/news/aqc/58_2004/20146.pdf> (20 December 2004).

³⁶ Hilda Bouma, "Engels jargon en 24 uur e-mailverkeer," Het Financieele Dagblad, 12 December 2004, p. 9.

³⁷ Robbert van het Kaar, EIRO comparative study: Developments in European Works Councils - case of the Netherlands, <<http://www.eiro.euofound.eu.int/2004/11/word/nl0409103s.doc>> (20 December 2004).

6. Norms and policies on sustainability and CSR

6.1. Philips' policy on sustainability

In March 2003, Philips launched its first annual Sustainability Report (over 2002), adding data on economic and social aspects to its former Environmental Report.

The second sustainability report, launched in March 2004, shows progress made against goals established in the 2002 version. An important step was the extension of the sustainability principles to Philips' 50,000 suppliers. Furthermore Philips challenges itself to develop five 'sustainable' product propositions by the end of 2004 in its strive to take sustainability to a higher level as a springboard for new business development. In the area of environmental responsibility, the report looks at Philips' EcoVision 2002-2005 achievements, which include reductions in energy consumption (9%) and water usage (15%). Finally, in 2003, Philips was recognized for its efforts in the area of sustainability with the world's number one ranking in 2003 Dow Jones Sustainability Index (DJSI) in its industry group.

Philips is a member of the World Business Council for Sustainable Development (WBCSD).³⁸ Philips measures and reports in accordance with the core indicators put forward by the Global Reporting Initiative³⁹ and had its Sustainability Report verified by KPMG.

Philips views sustainability in terms of:

- Overall corporate responsibility;
- Economic responsibility;
- Environmental responsibility;
- Personal responsibility (to their employees) and
- Social responsibility (to their customers, the local communities in which Philips operate and society at large).

The company has a so-called "sustainability framework", which comprehends all the instruments that Philips uses to test and improve its sustainability:

- General Business Principles
- Philips Values
- Sub-policies
 - ILO conventions
 - OECD guidelines
- Quarterly Monitoring
- Violations Reporting
- External Audit
- Public Accountability⁴⁰

³⁸ Cf. <http://www.wbcsd.ch>

³⁹ Cf. <http://www.globalreporting.org>

⁴⁰ Presentation by Jeroen Verstege (Philips), during the 25th International Conference on of Data Protection and Privacy Commissioners, 10 September 2003.

6.2. Sustainable development organisation structure

At corporate level, a *Sustainability Board* acts as an advisory body to the Board of Management. Chaired by a member of the Board of Management who has overall responsibility for the subject, the Sustainability Board includes corporate staff executives from the relevant functional disciplines. This board provides governance on the subject and track progress on sustainability issues throughout the company.

Philips has established a *Corporate Sustainability Office* to focus on environmental, health and safety, and social and community issues. Employees from the Environmental & Energy Office, Human Resources Management and Control who spend the majority of their time on sustainability matters have been reassigned to this new office. A Vice President heads the Corporate Sustainability Office, reporting to the Board of Management member responsible for sustainable development. This Vice President also serves as functional leader of the worldwide environmental network, and is employing this process with other internal networks to focus on the broad range of sustainability matters.

6.3. General Business Principles

The Philips General Business Principles govern the Company's business decisions and actions throughout the world, applying equally to corporate actions as well as the behaviour of individual employees when on company business. According to Philips, they incorporate the fundamental principles on which all Philips activity is or should be based: integrity, fair trade, non-discrimination and equal opportunities.

Philips states that the General Business Principles have been translated into the local language in almost all countries. These translations, however, are not all available on the internet. According to Philips, In most countries the Principles are now an integral part of labour contracts. In the countries where this is not the case, the employees sign a document confirming that they have received a copy of the General Business Principles. In order to further heighten awareness of the issue of business ethics, Philips has updated and expanded their dilemma training casebook.

The responsibility for compliance with the Principles rests first and foremost with the management of the business. In every product division and country organization a *Compliance Officer*⁴¹ has been appointed. The Philips Intranet provides information on how to contact the Compliance Officer.⁴² Philips has introduced "guaranteed-anonymity hotlines" for reporting of suspected contraventions of the General Business Principles in the entire Latin American region. Such a hotline was already in use in the USA.

The Board of Management has assigned final responsibility for coordination of all General Business Principles-related issues. To achieve full implementation of and compliance with the General Business Principles, country and product division management and Compliance Officers report twice yearly to the *Corporate Review Committee* on their progress in safeguarding that all employees are

⁴¹ It is recommended that the legal officer of the country organisation and the legal officer of the product division should be appointed as compliance officers. In this capacity they report to the country management and the management of the product division respectively (Business Principles, sub-policy).

⁴² It is not clear whether every employee has access to the intranet.

bound by the principles. In 2003 this issue was introduced as part of the General Business Principles *self-assessment questionnaire* with Philips' Statement on Business Controls.

6.4. Business directives

Philips has elaborated specific directives that constitute an integral part of the General Business Principles. The directives were introduced in December 2003 and can be summarized as follows:

1. Policy Statements on Conventions of the ILO

1.1. General statement about Conventions of the ILO

Philips has adopted internal procedures and guidelines with respect to topics covered by the seven Fundamental Conventions of the International Labour Organisation, such as forced labour, the right to organize, collective bargaining, discrimination and child labour.

1.2. Forced labour

Under no circumstances will Philips make use of forced or bonded labour - such as forced labour performed by persons placed in an institution, or compulsory labour including labour as a means of political coercion or education - to manufacture or assemble Philips products (ILO conventions 29 and 105)

1.3. Right to organise

Philips recognizes and respects the freedom of employees to choose whether or not to establish or to associate with any organization of their own choosing (including labour unions) without Philips' prior authorization (ILO conventions 87 and 98)

1.4. Collective bargaining

Philips respects - within the framework of (local) law, regulations and prevailing labor relations and employment practices - the right of its employees to be represented by labor unions and other employee organisations (ILO conventions 98 and 135).

1.5. Discrimination

Every employee has equal opportunities and will be treated equally in employment and occupation. Philips strives to offers equal pay for equal work performed at equal levels at similar locations. No form of harassment or discrimination in respect of employment and occupation will be tolerated, such as discrimination based on race, colour, sex, pregnancy, language, religion, political or other opinion, national or social origin, property, birth or other status (ILO conventions 100 and 111).

1.6. Child labour

Philips does not employ children in violation of conventions 138 and 182 of the International Labour Organisation.

2. Gifts

This directive describes Philips' policies towards the acceptance of gifts: "The acceptance of gifts or personal favours of commercial value is not acceptable. It is to be made clear to third parties that personal favours can only influence the business relationship negatively and that business

decisions are based solely on benefits to the Company and not on considerations of past or future personal gain.”

3. Engagement outside Philips

Philips expects its employees to be fully dedicated to the proper fulfilment of their jobs and to avoid any (potential) conflict of their personal or business activities and financial interests with such commitment. Financial reward received for services rendered to third parties should be made over to the Company.

4. Commission payments to third parties

4.1. General

According to Philips, commission payments to third parties is too difficult and complex a topic to be addressed exhaustively in specific guidelines. The objective is to make sure that the hard rule laid down in the General Business Principles on the prohibition of bribes in any form is not circumvented by commission payments.

4.2. Agents, distributors, commissioners

The remuneration of an agent, distributor, commissioner and the like may not exceed the normal and reasonable commercial rates for the legitimate service rendered by the agent.

4.3. Payments

Any payment for a company's products or services must be made to the company, not to an individual. All payments must be properly and fairly recorded in appropriate books of account available for inspection by Internal Audit. There must be no 'off the books' or secret accounts.

5. Facilitating payments

In general, Philips is opposed to the making of facilitating payments. The company will promote measures to eliminate such practices; at all events applicable laws and regulations should be complied with.

6. Contributions to political parties

Philips companies shall not make payments or donations, in money or in kind, to political parties, political organisations or individual politicians. Subject to applicable laws and regulations, exceptions to this prohibition may be made - where legally permissible - only if explicitly approved by the Regional Executive.

7. Money laundering

Philips will not participate in 'money laundering' by entering any arrangement which is known or there is reason to suspect that it will be used to facilitate any acquisition, retention, use or control of any property or money intended to disguise the proceeds of crime.

6.5. Specific policy on child labour

With regard to Child labour, "an extensive inventory of group companies has confirmed that Philips does not employ child labour". In 2002 this inventory was extended to major sub-contractors and suppliers in high-risk regions.⁴³ The objective was - in those situations where the study revealed that child labour is in fact used - to develop improvement programs in close cooperation with (local) NGOs in order to arrive at a situation that satisfies ILO Convention 138, taking local economic and cultural customs into account.

On the basis of ILO Convention 138 a clause on child labour has been developed that will be reviewed regularly as part of an overall sustainability standard for suppliers. This sustainability standard is being rolled out to key suppliers, and suppliers in a number of selected countries. The underlying principle is that suppliers should comply with the ILO norm about child labour. If a supplier does not comply with the ILO norm, it will draw up a plan with Philips to comply with the ILO norm, taking into account the interests of the children employed. This plan will include:

- Minimum employment conditions for the children employed (such as education, working hours, wages, medical facilities etc.);
- The obligation on the supplier not to employ any more children;
- a time period within which the supplier will comply with the ILO norm.

Nyenrode University in The Netherlands, in conjunction with an Indian university research group, is carrying out a follow-up study in India to develop a blueprint for an improvement plan (possibly as part of a suppliers clause on child / forced labour). To extend the scope, additional desk research is being carried out in China and Brazil.

6.6. Specific policy on Health and Safety

In 2003 Philips reviewed its health and safety policy, benchmarking it against competitors' policies and international standards. Philips contacted employees working in the health and safety area via its "Yellow Pages" database, and included input from respondents representing 23 countries and all four regions.

The updated policy will be finalized in 2004 and included in the report that will be published in 2005.

In 2002, Philips identified the reporting organizations and started a pilot program covering a number of parameters, such as incidents rate, lost work time rate and fatalities. These reporting parameters were identified by means of a benchmark study with a number of companies experienced in this field, mainly in base industry.

Philips also took the US Occupational Safety & Health Administration (OSHA) regulations into account, as definitions and that type of reporting is becoming standard in many industries worldwide. This provides the company with the opportunity to benchmark in a later stage internally between different product sectors, as well as externally with aggregated benchmark data, for example in different sectors in the USA.

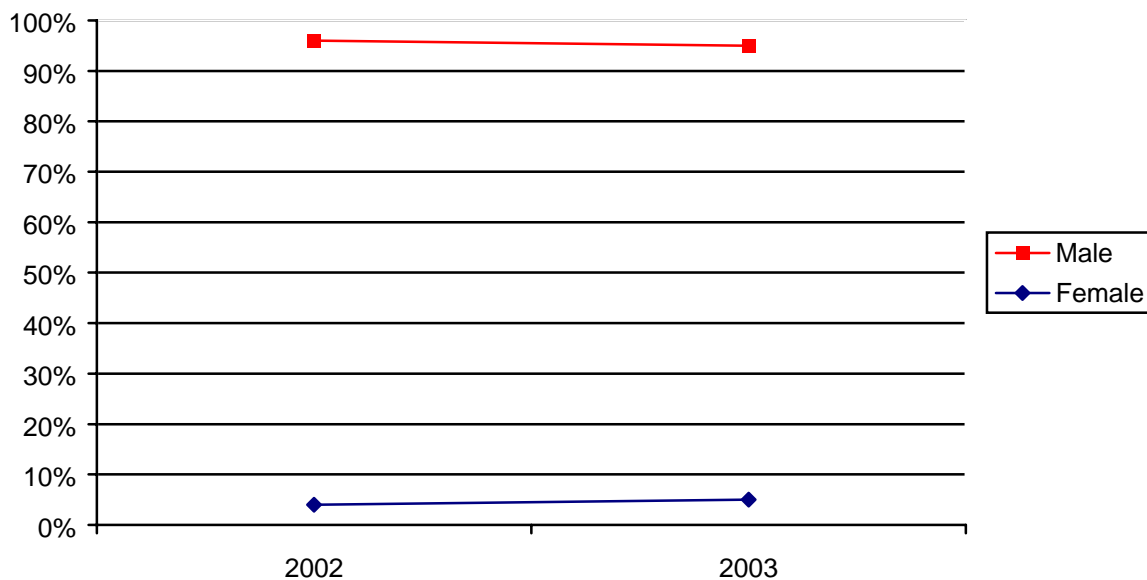
⁴³ Philippines, China, Thailand, Pakistan, India, Mexico, Brazil, Hungary and Poland.

While Philips intends to report verified data for 2003 on these parameters, the collected data does not yet meet the company's standards of reliability. Philips is adding two self-assessment tools in 2004 for its reporting organisations - one on the quality of their health and safety management systems and another on data reporting.

6.7. Specific policy on gender issues

In the company's Sustainability Report 2002, Philips announced that it wants to increase the percentage of women and non-Dutch nationals in key executive positions. The company is working to increase the number of women in senior management. Philips wants to raise the percentage to at least 10% within four to five years, more than doubling its 4% level in 2002. The percentage increased to 5% in 2003.⁴⁴

Composition of Philips executives in 2002 and 2003



6.8. Specific environmental policy

The Philips EcoVision 2002-2005 program includes supplier management of environmental issues, because Philips thinks that purchased materials influences the environmental performance of the company's products and processes. EcoVision calls for the use of a maturity grid to assess progress in supplier management. Because this environmental program was developed before the issuance of the company's sustainability policy, Philips is revising the maturity grid to incorporate other sustainability elements. Therefore, Philips was not ready in 2004 to report results in this area. The company will follow up with information on our progress in the 2005 report.

Company policy requires that all manufacturing sites achieve ISO 14001 certification and introduce environmental management systems to realize this goal. The company also recommends that all non-industrial facilities obtain certification.

⁴⁴ <http://www.philips.com/assets/Downloadablefile/final-pdf-SAR-2003-12989.pdf> (22 December 2004), p. 29.

The percentage of certified units at year-end 2003 increased slightly to 89% in 2003. This change includes four reporting organizations whose certificate expired, five units that were divested and 10 units that were certified for the first time.

Philips reports data on its carbon dioxide emissions from production caused by burning fossil fuels. Known as direct emissions, these are emissions the company can control. Based on a UN conversion, the calculated amount of CO₂ emissions from production in 2003 is 350 kilotons, compared with 394 kilotons in 2002. This is an absolute decrease of 11% and is in line with the 9% decrease in absolute energy consumption. The absolute energy and CO₂ reductions are not completely parallel, due to a different mix of types of energy (electricity, gas, others) used in 2003 versus 2002. The comparable CO₂ decrease in 2003 versus 2002 is 13%, and 30% versus the base year 2001.⁴⁵

6.9. Specific policy on military and defence contracts

In principle, Philips does not produce or renders services specially designed or developed for the military, except for the following products:

- F 16 parts and Apache parts supplied to NATO countries (under compensation agreements US/Netherlands)⁴⁶
- Optical parts for reconnaissance supplied to France
- Chips for telecommunication supplied to the US and Germany
- Targeting laser equipment supplied to Turkey⁴⁷
- Tapers supplied to Germany
- Parts for the Nimrod aircraft supplied to the U.K

Philips units developing and / or producing these products are based in The Netherlands and the USA. Philips adheres to the export regulations of the respective national governments and the relevant provisions of international law.

According to Philips, the total revenues amount to less than 0,04% of the total group revenues.

⁴⁵ <http://www.philips.com/assets/Downloadablefile/final-pdf-SAR-2003-12989.pdf> (22 January 2004).

⁴⁶ The parts supplied by Philips are used in the United States to produce F 16 jet fighter aircrafts and Apache helicopters. Some of these machines have been sold to the Israeli military and are currently used in bomb raids.

⁴⁷ In the early 1990s, the Turkish army was involved in the forced displacement of at least 380.000 Kurdish villagers. Most internally displaced persons (IDPs) in Turkey still live in conditions of hardship and poverty in the cities, with no state assistance or compensation. Government initiatives for return have been mainly cosmetic while the government has yet to implement the recommendations from the international community— including calls by the U.N. Special Representative of the Secretary General on Internal Displacement, the U.N. Special Rapporteur on extrajudicial, summary or arbitrary executions and the Parliamentary Assembly of the Council of Europe to abolish the corrupt paramilitary village guard corps. As the October 2004 Commission Regular Report stated: "On the ground, the situation of internally displaced persons remains critical. A number of obstacles, including the village guard system and the absence of basic infrastructure, currently prevent displaced people from returning to their villages." Cf. <http://hrw.org/english/docs/2004/12/15/turkey9865.htm> (22 December 2004).

Philips states that it cannot rule out the possibility of the supply of goods / services for general purposes, which are not specially designed for military purposes, to other military customers.

6.10. Specific policy on the OECD Guidelines for Multinational Enterprises

On June 26, 2000 the OECD Guidelines for multinational enterprises (MNEs) were formally adopted by 33 countries, including all major developed countries. The Guidelines are recommendations addressed by governments to MNEs, providing voluntary principles and standards for responsible business conduct.

Although the Guidelines are not legally binding, OECD governments are committed to promoting their observance. Philips states that it “welcomes” the Guidelines, that it has distributed them at executive / compliance level throughout the organisation, and that it sees the Guidelines as an important aid to the further implementation of its General Business Principles.

7. Attachments

Attachment 1: Philips' General Business Principles

The aim of Philips' General Business Principles is to set the guiding principles of Philips' ethics in business conduct. They have been adopted by the Board of Management of Royal Philips Electronics N.V. and approved by its Supervisory Board. They govern Philips' business decisions and actions throughout the world and apply equally to corporate actions and to individual behaviour of employees in conducting Philips' business. They are subject, however, to due observance of the applicable rules of the law of the countries in which the act or conduct occurs.

The General Business Principles are not all-encompassing, but formulate minimum requirements of behaviour. They leave product divisions and country management free to specify further local rules of business conduct.

Philips states that the General Business Principles will be reviewed on a regular basis and revised if necessary.

At the end of 2003, an updated version of the General Business Principles was introduced. With a view to ensuring maximum transparency for shareholders and other interested parties, a section of Philips' website (www.investor.philips.com) was dedicated to specific issues of business ethics, such as political payments, military and defence contracts, and child labour.

1. General commitment

Philips' mission is to improve the quality of people's lives through the timely introduction of meaningful technological innovations. In a world where technology increasingly touches every aspect of our daily lives, Philips aspires to be a leading solutions provider in the areas of healthcare, lifestyle and enabling technology, delighting its customers with products and services that meet and even exceed their expectations.

Philips wishes to be a responsible partner in society, acting with integrity towards its shareholders, customers, employees, suppliers and business partners, competitors, governments and their agencies and others who can be affected by its activities. Philips duly observes the applicable rules of the law of the countries in which it operates and regularly reviews its interests and those of affected persons or entities in order to ensure a healthy, long-term relationship with them. Philips endeavours to adapt to local situations in order to take the most appropriate approach to possible problems within the bounds of applicable law and responsible conduct. In this respect Philips supports the principle of dialogue and cooperation with all parties involved.

1.1. Human rights

With due regard to the Universal Declaration of Human Rights, which states that all parties in society, including corporate persons, have a duty to respect and safeguard human rights, and within the framework of the legitimate role of businesses, Philips supports and respects human rights and strives to ensure that its activities do not make it an accessory to infringements of human rights.

1.2. Child, bonded and forced labour

Under no circumstances will Philips make use of forced or bonded labour, nor will it employ children in violation of Conventions no. 138 and no.182 of the International Labour Organization.

1.3. Free market competition

Philips supports the principle of free market competition as a basis for conducting its business and observes applicable competition laws and regulations.

1.4. Product safety

Philips aims, at all times, to supply safe products and services.

1.5. Privacy

The privacy of personally identifiable information about customers, employees, business partners and other individuals will be protected.

1.6. Environmental protection

Consistent with Philips' commitment to sustainable development, it will do all that is reasonable and practicable to minimize any adverse effects of its activities on the environment.

2. Commitment towards customers

Philips is driven to improve people's lives. Its goal is to constantly delight each customer with breakthroughs both large and small. To this end, the company seeks to maintain an ongoing dialogue with its customers. Philips is committed to listen to and learn from them, so that it is able to design and deliver the solutions they really want and need. Philips will always deal with its customers in a fair and forthright manner, maintaining the highest levels of integrity.

3. Commitment towards shareholders

It is of central importance to Philips to conduct its operations in accordance with the highest standards of internationally accepted principles of good corporate governance. Philips aims to achieve a satisfactory return on equity, with the intention of maintaining a sustainable dividend payment to shareholders, while at the same time retaining sufficient funds in the company to generate profitable growth. Philips attaches great value to its relations with its shareholders and the financial markets and provides timely, regular and reliable information on its activities, structure, financial position and performance.

4. Commitment towards employees

Philips values its employees as a key resource. An atmosphere of good employee communication, involvement and responsibility is of central importance, and an employee's personal development and optimum use of talents is encouraged.

4.1. Right to organize

Philips recognizes and respects the freedom of employees to choose whether or not to establish, or to associate with, any organization. Philips respects - within the framework of (local) law, regulations and prevailing labour relations and employment practices - the right of its employees to be represented by labour unions and other employee organizations, and Philips will engage in

negotiations, either on its own behalf or through employers' associations, with a view to reaching agreement on employment conditions.

4.2. Health and safety

Philips will do all that is reasonable and practicable to protect the health and safety of its employees.

4.3. Equal and fair treatment

Every employee has equal opportunities and will be treated equally in employment and occupation regardless of personal background, race, gender, nationality, age, sexual preference or religious belief. The same applies to the recruitment of employees. Philips strives to offer equal pay for equal work performed at equal levels at similar locations. No form of harassment or discrimination will be tolerated.

4.4. Wages and payment

Remuneration and working hours shall comply with local labour laws and shall at least be in line with prevailing industry norms.

5. Commitment towards suppliers and business partners

Philips pursues mutually beneficial relationships with its suppliers and business partners. It seeks to award business to suppliers and business partners who are committed to act fairly and with integrity towards their stakeholders and who observe the applicable laws of the countries in which they operate.

6. Assets and information

6.1. Use and protection of assets

Each employee is responsible for the proper use, protection and conservation of Philips' assets and resources as well as confidential information disclosed to Philips by its business partners. Philips' assets and resources as well as any opportunities arising by virtue of one's position, are to be used solely to pursue and achieve Philips' goals and not for personal benefit.

6.2. Improper disclosure

Philips regards information for the purpose of its business as a corporate asset that must be protected against loss, infringement and improper use and disclosure.

Philips is committed not to make use of information disclosed to it by a third party if it is suspected that the discloser thereby violates an obligation of confidentiality, unless the information:

- a) is generally available to the public other than as a result of disclosure by Philips;
- b) has been independently developed by Philips; or
- c) becomes available to Philips either on a non-confidential basis from a third party who is not bound by any confidentiality obligations or by operation of law.

6.3. Insider trading

All employees shall comply with Philips' insider trading rules. This means that non-public information which might influence the market price of Philips shares shall be kept in strict

confidence until publicly released by authorized management. Furthermore, employees who have sensitive information which could influence the price of Philips shares and related rights, must refrain from directly or indirectly executing transactions in Philips shares and related rights. Additionally, employees have to comply with statutory rules and regulations concerning insider trading with respect to securities of other listed companies.

7. Business integrity

7.1. Bribery; records of transactions

Philips insists on honesty, integrity and fairness in all aspects of its business. Bribes in any form are unacceptable; commission payments and personal gifts or favours may only be made or accepted in strict accordance with the GBP Directives. Philips strives to comply with the highest levels of transparency and accountability throughout the company. Records of transactions should be maintained in an accurate, complete and timely manner in accordance with Philips accounting principles. No unrecorded funds or assets should be established or maintained.

7.2. Third-party interests

Employees are not allowed to have any direct or indirect financial interest in a supplier or competing company with the exception of a financial interest in a publicly traded company.

7.3. Political payments

Philips companies shall not make payments or donations, in money or in kind, to political parties, political organizations or individual politicians, unless such payments are made in strict accordance with the GBP Directives.

8. Observance of the General Business Principles

8.1. Sanctions

All Philips employees must comply with the General Business Principles. Violation may lead to disciplinary action, including dismissal, notwithstanding any further civil or criminal action that may be taken.

8.2. Whistleblower policy

In order to promote the reporting of violations of the General Business Principles, a whistleblower policy is in place, enabling employees to submit complaints on an anonymous basis without fear of the complaints leading to disciplinary action.

8.3. Compliance

Compliance with the General Business Principles is monitored via a worldwide network of Country and Product Division compliance officers, who regularly report to the Corporate Review Committee GBP, which advises the Board of Management on the deployment of the General Business Principles and on ethical issues in general.

Reporting on compliance with the General Business Principles is also an integral part of the Statement on Business Controls issued annually by the management of each business unit/department as part of a cascade process leading to CEO/CFO certification of the company's annual accounts. Compliance processes and procedures are audited by Philips' Corporate Internal Audit department.

Attachment 2: Implementation

In recent years, Philips has taken significant steps to increase transparency and accountability as regards adherence to business principles. The Review Committee General Business Principles meets with various consultative bodies and interest groups to discuss Philips' performance in this respect and its planned initiatives to achieve full-scale implementation and compliance.

Implementation

The Board of Management is convinced of the need for further progress, to achieve full compliance, and has, accordingly, taken a number of initiatives such as the inclusion of General Business Principles compliance in the Statement on Business Controls and the issue of a casebook for dilemma training.

General Business Principles

The Philips General Business Principles govern the Company's business decisions and actions throughout the world, applying equally to corporate actions as well as the behaviour of individual employees when on company business. They incorporate the fundamental principles on which all Philips activity is or should be based: integrity, fair trade, non-discrimination and equal opportunities. The General Business Principles have been translated into the local language in almost all countries. In most countries they are now an integral part of the labour contract. In the countries where this is not the case, the employees sign a document confirming that they have received a copy of the General Business Principles. The responsibility for compliance with the Principles rests first and foremost with the management of the business. In every product division and country organization a Compliance Officer has been appointed. The Philips Intranet provides information on how to contact the Compliance Officer.

Update of the General Business Principles

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

ILO Conventions

Philips supports the aim of the International Labour Organization to arrive at universally accepted labour standards. Philips has adopted in 2002 internal policies with respect to topics covered by the seven Fundamental Conventions of the International Labour Organization, such as forced labour, the right to organize, collective bargaining, discrimination and child labour. The policies adopted by Philips on these fundamental issues form an integral part of the Philips General Business Principles.

Review Committee General Business Principles

The Board of Management has assigned final responsibility for coordination of all General Business Principles-related issues to the Review Committee General Business Principles, chaired by the Secretary to the Board of Management/Chief Legal Officer, who is a member of the Group Management Committee.

Embedding of GBP in business control framework

In 2003 a self-assessment questionnaire (including compliance with the ILO Core Conventions which Philips has endorsed) was developed to help management complete the General Business Principles section of the annual Statement on Business Controls. This checklist is incorporated in the GBP self-assessment questionnaire. In a letter accompanying this questionnaire, the President of the

Company reiterated the paramount importance of compliance with the General Business Principles in all actions and at all levels of the organization.

Internet

With a view to ensuring maximum transparency for shareholders and other interested parties, a section of our Internet site (www.philips.com/investor) is devoted to specific issues of business ethics, such as political payments, military and defence contracts, and child labour.

Standardized reporting of GBP violations

In order to eliminate confusion and inconsistency regarding what has to be reported, the worldwide GBP data collection and reporting system has been standardized under the responsibility of the Review Committee GBP and in close cooperation with Internal Audit. The process is in its final stages and will be rolled out in the first quarter of 2004. The system covers all identified non-compliances with the GBP and has the following characteristics:

- A standard worldwide approach for collecting and handling allegations of non-compliance with the GBP;
- A standard workflow, applicable to all Compliance Officers, for recording and reporting on all non-compliances with the GBP;
- a common, integrated information architecture supporting the standard workflow described above.

Hotlines

In order to encourage reporting of GBP violations, guaranteed-anonymity hotlines have been introduced in many countries. As of year-end 2002, such hotlines were in place in the Philips organizations in the USA and Canada, all countries in Latin America, the Netherlands, South Africa, Australia and New Zealand, South Korea and Singapore. In the course of 2003 hotlines were introduced in the Philippines, Thailand, Indonesia, Malaysia, Japan, Hungary, Poland, Slovenia, the United Kingdom and Italy. In addition, a number of other European countries will be introducing hotlines in the beginning of 2004.

Sustainability indexes

In September 2003, Philips was ranked number one by the Dow Jones Sustainability Index (DJSI) World in corporate sustainability among companies from the consumer electronics, leisure goods, home construction, apparel and airline sectors. Dow Jones Sustainability Indexes track the financial performance of the leading sustainability companies worldwide, providing asset managers with reliable and objective benchmarks to manage sustainability-driven portfolios. The DJSI World covers the largest 2,500 companies by market capitalization in the Dow Jones Global Index. Only the top 10% of these companies are selected for the DJSI World according to economic, environmental and social criteria. Philips ranked first in the Cyclical Goods & Services market sector and also came out on top in the DJSI STOXX index ranking of approximately 600 of Europe's leading companies.

In the September 2003 review of the FTSE4Good index series Philips was again selected for inclusion in the following key FTSE4Good indices: FTSE4Good Europe (benchmark), FTSE4Good Global 100 (tradable), FTSE4Good Europe 50 (tradable) and FTSE4Good Global (benchmark).⁴⁸

⁴⁸ <http://www.philips.com/about/investor/section-13629/index.html> (22 December 2004).