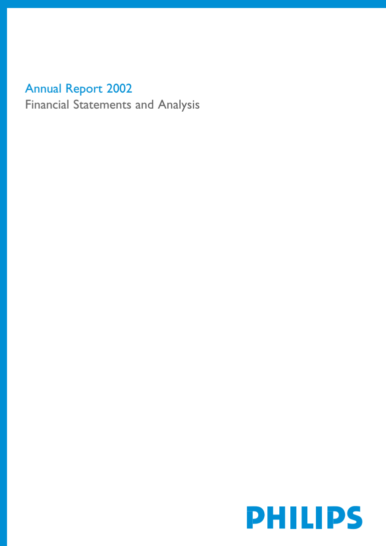

'Safe Harbor' Statement under the Private Securities Litigation Reform Act of 1995
This document contains certain forward-looking statements with respect to the financial condition, results of operations and business of Philips and certain of the plans and objectives of Philips with respect to these items (including, but not limited to, cost savings), in particular the outlook paragraph of the 'Operating and Financial Review and Prospects' in this 'Financial Statements and Analysis' booklet.
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.

Market share estimates contained in this report are based on outside sources such as specialized research institutes, industry and dealer panels, etc. in combination with management estimates. Rankings are based on sales unless otherwise stated.

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This Financial Statements and Analysis booklet and the separate booklet entitled 'Management Report' together comprise the full Annual Report for the year 2002 of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics').
For a full understanding of the results of the Philips Group and the state of affairs, both booklets should be consulted.

Financial highlights

all amounts in millions of euros unless otherwise stated

	2002	2001	2000
Sales	**31,820**	32,339	37,862
Income (loss) from operations	**420**	(1,395)	4,258
As a % of sales	**1.3**	(4.3)	11.2
As a % of net operating capital (RONA)	**3.2**	(9.3)	35.6
Net income (loss)	**(3,206)**	(2,475)	9,662
Per common share - basic	**(2.51)**	(1.94)	7.36
- diluted	**(2.51)**	(1.94)	7.28
Dividend paid per common share in euros (related to prior financial year)	**0.36**	0.36	0.30
Cash flows before financing activities	**1,980**	(3,316)	592
Stockholders' equity	**13,919**	19,160	22,707
Per common share	**10.91**	15.04	17.69
Net debt : group equity ratio	**27:73**	26:74	11:89
Employees	**170,087**	188,643	219,429
Excluding special items *:			
Income (loss) from operations	**460**	(160)	3,188
As a % of sales	**1.4**	(0.5)	8.4
As a % of net operating capital (RONA)	**3.5**	(1.1)	26.6
Net income (loss)	**208**	(779)	2,891

Philips has applied US GAAP in its reporting from January 1, 2002 onwards. Previous periods have been restated accordingly.

* Special items relate to income and expenses resulting from business operations, which, because of their nature, are disclosed separately to give a better understanding of the underlying result for the period. Special items include items such as restructuring and impairment charges, acquisition-related charges and gains and losses on the disposal of businesses or participations and real estate. However, the reader should note that net income excluding special items is not a measure of financial performance as defined by US GAAP or Dutch GAAP.

Operating and Financial Review and Prospects

The following discussion is based on the consolidated financial statements and should be read in conjunction with those statements and the other financial information.

Starting January 1, 2002 the consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP). These accounting principles differ in some respects from generally accepted accounting principles in the Netherlands (Dutch GAAP), which differences are explained in the notes to the Dutch GAAP financial statements. All relevant reporting periods have been restated according to US GAAP.

In order to facilitate a better understanding of the underlying business performance of our segments, we have analyzed results of operations with a discussion of special items. Special items, as presented in the Operating and Financial Review and Prospects, relate to income and expenses resulting from business operations which, because of their nature, are disclosed separately to give a better understanding of the underlying result for the period. These include items such as restructuring and impairment charges, acquisition-related charges and gains and losses on the disposal of businesses or participations and real estate. This is consistent with how business performance is evaluated by Management. However, the reader should note that net income excluding special items is not a measure of financial performance as defined by US GAAP or Dutch GAAP.
The reader is encouraged to give equal attention to the reported GAAP measures and the analysis excluding special items.

The year 2002

Summary

The Company's performance in 2002 was heavily impacted by poor worldwide economic conditions and a continued decline in the main financial markets around the world. Despite the challenging economy, each of our sectors improved their operating performance compared to 2001. Lighting, Domestic Appliances and Personal Care (DAP) and Medical Systems, which operate in less cyclical markets, delivered solid results, with DAP recording its best year ever. Additionally, Consumer Electronics returned to profitability. Semiconductors and Components were significantly affected by the depressed telecommunications and PC-related markets. Despite improving their performance compared to 2001, both sectors incurred losses for the year. The decline in the financial markets had a significant negative effect on the value of some of the Company's investments, causing significant write-downs.

In contrast to 2001, when the Company acquired several large businesses, 2002 was characterized by the continued integration of the recently acquired medical activities and a refinement of the portfolio during the year, with the Company making only a few relatively minor acquisitions. A number of businesses that were either low-growth low-return or did not fit strategically were divested. Cash of EUR 187 million was generated from the divestments, net of acquisitions. Additionally, during the year, the Company continued its focus on cost control, asset management and cash flow. We introduced 'Transforming into One Philips' (TOP), a program designed to streamline various support functions by standardizing services and introducing a shared way of working. This has resulted in significant cost savings. Additionally, we continued to focus on optimizing asset management, increasing the use of outsourcing, reducing working capital, shortening the cash conversion cycle and reducing debt. In part aided by the enhanced focus on these areas, the Company generated a positive cash flow from operations of EUR 2,228 million in 2002, compared with EUR 1,248 million in 2001 and EUR 2,996 million in 2000.

Sales in 2002 totaled EUR 31,820 million, which is 2% lower than in 2001. Medical Systems recorded a 42% increase in sales (of which 5% was organic growth), largely due to the effect of the 2001 acquisitions. Further growth was achieved in the sectors DAP and Components (predominantly in Mobile Display Systems). All other sectors registered decreases, reflecting the softness in their markets. In particular, Consumer Electronics' sales were significantly below 2001. The decline was attributable not only to the general softness of the markets but also to significantly lower sales of Digital Networks and GSM phones, in part reflecting the strategy to change business models.

A net loss of EUR 3,206 million was incurred in 2002, compared with a loss of EUR 2,475 million in 2001 and net income of EUR 9,662 in 2000. A number of special items impacted the Company's financial performance during 2002.

The major financial markets around the world declined for the third year in a row. This had a significant negative effect on the value of the Company's financial assets. During 2002, the Company recorded non-cash impairment charges of EUR 1,955 million to recognize other-than-temporary declines in the value of certain security investments, the most significant of which was Vivendi Universal (EUR 1,855 million). Additionally, the Company recorded other non-cash charges of EUR 1,305 million to write down its investment in certain unconsolidated companies, mainly Atos Origin (EUR 921 million) and LG.Philips Displays (EUR 275 million).

The non-cash impairment charges and value adjustments related to securities and shareholdings included in income over the last three years are summarized below:

amounts 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

In 2002 the Company realized net gains of EUR 569 million from the sale of certain businesses and fixed assets. However, the impact on income from operations was offset by restructuring, impairment and acquisition-related charges of EUR 609 million.

Presented below is a table that summarizes the special items affecting net income for the years 2000 through 2002.

Net income (loss) excluding special items:

amounts in millions of euros

	2002	2001	2000
As published	**(3,206)**	(2,475)	9,662
Affecting income from operations:			
Write-down of inventories in connection with restructuring (cost of sales)	**(10)**	(307)	(10)
Restructuring and impairment charges	**(503)**	(786)	(187)
Acquisition-related costs incl. in-process R&D	**(96)**	(437)	(114)
Gain on sale of participations/fixed assets	**569**	295	309
Atos Origin merger gain			1,072
Affecting financial income and expenses:			
Gain on sale of JDS Uniphase shares			1,207
Gain on sale of ASML shares	**67**		
Seagram/Vivendi share exchange gain, net			1,115
Impairment Vivendi/Great Nordic/Uniphase	**(1,955)**	(526)	
Income taxes related to special items	**127**	313	(18)
Affecting results relating to unconsolidated companies:			
Gain on sale of shares and participations	**5**	20	2,717
Restructuring and impairment charges	**(301)**	(89)	
Dilution (losses) gains related to TSMC's equity transactions	**(12)**	(60)	680
Impairment charges recorded by the Company	**(1,305)**	(119)	
Excluding special items	**208**	(779)	2,891

Net cash provided by operating activities totaled EUR 2,228 million in 2002, compared with EUR 1,248 million in 2001 and EUR 2,996 million in 2000. The improvement compared to 2001 is primarily attributable to the signifcant improvement in operating performance (excluding the non-cash charges) and a decrease in working capital. The decrease in working capital reflects a reduction of inventories, due in part to supply chain improvement programs, as well as the success of the cash conversion cycle program that was started three years ago. Consumer Electronics in particular lowered its asset base to almost zero at year-end 2002.

Net cash used for investing activities totaled EUR 248 million for the year. EUR 626 million was used for the purchase of businesses and investments in unconsolidated companies. The most significant related to a settlement associated with the establishment of the joint venture LG.Philips Displays and a subsequent cash injection (EUR 250 million), a final payment to Agilent in respect of the business acquired in 2001 (EUR 90 million) and a capital injection of EUR 69 million to SSMC. In 2001, cash used for investing activities amounted to EUR 4,564 million, of which EUR 3,636 million was for the purchase of businesses, particularly for Medical Systems. In 2000, EUR 3,209 million was related to the purchase of businesses.

Proceeds from the sale of businesses in 2002 totaled EUR 813 million, of which the sale of Philips Contract Manufacturing Services (PCMS), Analytical and Communication, Security and Imaging (CSI) were the most significant. In 2001 the proceeds from the sale of businesses totaled EUR 755 million. Of these, the most significant were the Glass activities of Components, together with part of the shareholding in FEI and Philips Broadcast.
Gross capital expenditures were scaled back by approximately half, compared to 2001, to EUR 1,161 million as Philips aligned its component and semiconductor manufacturing facilities to the lower level of market demand. In 2001, cash requirements for capital expenditures totaled EUR 2,143 million, significantly below the level of EUR 3,170 million in 2000.

Net cash used for financing activities in 2002 amounted to EUR 897 million. EUR 300 million received from the issuance of long-term debt in August was subsequently used to retire short-term debt. Philips shareholders received distributions in cash totaling EUR 459 million.
In 2001 net cash provided by financing activities totaled EUR 3,159 million, compared to EUR 2,038 million of net cash used in 2000. The financing needs in 2001 were met by the issuance of two tranches of two eurobonds each, totaling EUR 4,250 million. The cash requirements for financing activities in 2000 included capital repayments to shareholders of EUR 1,673 million from the share reduction program.

At the end of 2002, Philips had a *net debt* position (debt, net of cash and cash equivalents) of EUR 5,251 million, which was EUR 1,725 million lower than the year before. The net debt to group equity ratio was 27:73 at the end of 2002, compared to 26:74 at year-end 2001.

Stockholders' equity decreased by EUR 5,241 million to EUR 13,919 million at year-end 2002. This decrease was mainly due to the net loss of EUR 3,206 million in 2002, currency translation effects, declines in the fair value of available-for-sale securities and increases in pension liabilities in other comprehensive income. Furthermore, EUR 459 million was distributed in cash to shareholders from retained earnings.

Group sales and income from operations

amounts in millions of euros	**2002**	2001	2000
Sales	**31,820**	32,339	37,862
% nominal (decrease) increase	**(2)**	(15)	20
Income (loss) from operations*	**420**	(1,395)	4,258
as a % of sales	**1.3**	(4.3)	11.2
Income (loss) from operations excl. special items*	**460**	(160)	3,188
as a % of sales	**1.4**	(0.5)	8.4
Net operating capital	**10,539**	14,309	14,370
Employees	**170,087**	188,643	219,429
*) Incl. amortization of goodwill	–	(180)	(173)

In percentage terms the composition of the change in sales over 2001 and 2000 was as follows:

	2002 versus 2001	2001 versus 2000
Consolidation changes	2.6	(0.7)
Currency effects	(3.5)	0.1
Prices	(6.5)	(8.2)
Volume	5.8	(5.8)
Nominal change	(1.6)	(14.6)

Sales

Sales in 2002 totaled EUR 31,820 million, 2% lower than the year before. Consolidation changes had a positive effect of 3%, primarily resulting from the 2001 medical acquisitions, partially offset by the effect of various divestments as well as the deconsolidation of Display Components mid-2001. Weaker currencies impacted nominal sales by 4%, particularly as a result of the weaker US dollar and the weaker Asian currencies. Sales volume increased by 6%, while average prices were 7% lower than in the year before.
Excluding the effect of consolidations and currencies, increased sales were achieved in the sectors DAP, Components and Medical Systems. On the downside, comparable sales were lower in Lighting, Consumer Electronics and Semiconductors. The sector Consumer Electronics was particularly affected by lower sales of Digital Networks and GSM phones, in part reflecting the strategy to change the business models.

Sales in 2001 totaled EUR 32,339 million, 15% lower than in 2000. Changes in consolidations had a 1% negative effect. Sales volume decreased by 6%, while average prices declined by 8%. Sales at Semiconductors, Components and Consumer Electronics were affected by the downturn in the respective markets. Sales at Lighting remained virtually flat, while sales at DAP and Medical Systems increased strongly, both organically and as a result of acquisitions.

Income from operations

Income from operations in 2002, a EUR 420 million profit, improved considerably compared with the 2001 loss of EUR 1,395 million. All sectors contributed to the improvement. Consumer Electronics returned to profitability, with a significant improvement in income from operations over 2001. Additionally, Medical Systems, whose performance in 2001 was impacted by significant acquisition-related charges, also returned to profitability.
Lighting and DAP once again delivered strong results. Although Semiconductors and Components achieved improved results compared to 2001, both sectors incurred losses for the year. The results of both sectors were influenced by restructuring charges.
The year 2002 included lower amortization charges as a result of the change-over to US GAAP. Excluding special items and goodwill amortization, income from operations improved by EUR 440 million due to strong margin improvements in all sectors as well as savings on overhead costs and positive synergy effects at Medical Systems. These improvements were achieved despite an increase in pension costs of EUR 541 million over 2001, which is primarily attributable to a decline in the value of pension plan assets due to the major downturn experienced in the financial markets. As a consequence of a continued decline in stock markets, it is anticipated that pension expense will increase further in 2003.

During the year 2002 the business portfolio was scrutinized and rationalized as part of the low-growth low-return divestment program. A number of businesses were sold in 2002, including the Fax business, TechnoFusion, SMATV, Heat and Surface Treatment, Philips Broadband Networks, Analytical, CSI, Philips Contract Manufacturing Services, Health Care Products Group of Medical Systems and Payer. Together these divestments resulted in cash proceeds totaling EUR 720 million and a gain of EUR 311 million.
A gain of EUR 40 million related to the sale of the CRT glass activities was recorded and a EUR 40 million currency translation gain resulted from the liquidation of certain Components activities in Japan. Furthermore, an earn-out of JDS Uniphase shares, received from the sale of Philips Optoelectronics in 1998, resulted in a gain of EUR 113 million. Sale of real estate resulted in a EUR 65 million gain.
Other special items in 2002 related to EUR 96 million acquisition-related charges in the Medical Systems and Semiconductors sectors and major restructuring projects in PCMS (related to the aforementioned sale, at various sites), Components, Semiconductors (old CMOS lines), Consumer Electronics (Monitors site at Juarez) and DAP (Hoogeveen site) for a total of EUR 513 million. This amount includes impairment charges totaling EUR 47 million related to the sale of Medical Systems' HCP.

Excluding all special items, 2002 income from operations came to a positive EUR 460 million. Income from operations in 2001, excluding special items, amounted to a EUR 160 million loss but included EUR 180 million amortization of goodwill. Major special items in 2001 were the sale of FEI, charges related to the acquisition of Agilent and Marconi at Medical Systems, several restructurings (among others at Consumer Electronics' Le Mans site, Components, Semiconductors and Miscellaneous) and non-recurring write-offs of inventories (mainly Consumer Electronics).

Sales and income from operations per sector

amounts in millions of euros	**2002**		2001		2000	
	sales	income (loss) from operations	sales	income (loss) from operations	sales	income (loss) from operations
Lighting	**4,845**	**602**	5,083	582	5,052	668
Consumer Electronics	**9,600**	**230**	11,052	(649)	13,060	410
DAP	**2,273**	**401**	2,224	334	2,107	287
Components	**2,212**	**(329)**	2,772	(667)	5,042	608
Semiconductors	**4,089**	**(537)**	4,389	(607)	5,879	1,346
Medical Systems	**6,844**	**309**	4,834	(163)	3,031	169
Miscellaneous	**1,957**	**74**	1,985	(104)	2,974	(191)
Unallocated	**–**	**(330)**	–	(121)	–	(102)
Origin	**–**	**–**	–	–	717	1,063
	31,820	**420**	32,339	(1,395)	37,862	4,258

Lighting

amounts in millions of euros	**2002**	2001	2000
Sales	**4,845**	5,083	5,052
% nominal (decrease) increase	**(5)**	1	11
Income from operations*	**602**	582	668
as a % of sales	**12.4**	11.4	13.2
Income from operations excl. special items*	**616**	600	685
as a % of sales	**12.7**	11.8	13.6
Net operating capital	**1,723**	1,979	1,903
Employees	**46,870**	47,922	47,124
*) Incl. amortization of goodwill	**–**	(8)	(9)

Sales

Sales at Lighting in 2002 totaled EUR 4,845 million and were on a nominal basis 5% and on a comparable basis 2% lower than in 2001. Sales volume increased by 1%, while average prices were 3% lower. This was mainly due to the general softness of the market. Luminaires in particular had to contend with difficult market conditions, while Automotive & Special Lighting continued to show growth through innovation. Sales growth in Asia Pacific continued, while Latin American sales levels remained weak. The market slowdown in Europe and North America had a negative impact on sales.

Sales at Lighting in 2001 totaled EUR 5,083 million, slightly higher than in the year before. The level of the increase was affected by the economic slowdown, particularly in USA/Canada, and the energy crisis in Brazil. Adjusted for the divestment of the Batteries business, sales growth was 2%. Sales growth was particularly strong at Automotive & Special Lighting. Geographically, sales growth was strongest in Asia Pacific. All businesses contributed to a slight improvement in overall market share, reinforcing global market leadership.

Income from operations

Income from operations in 2002 totaled EUR 602 million, or 12.4% of sales, and was above last year's 11.4%, mainly due to focused marketing management, tight cost control and more volume in high-end products. The 2002 result included net restructuring charges of EUR 13 million for the discontinuation of various activities in the Netherlands.

Income from operations in 2001 totaled EUR 582 million, or 11.4% of sales, and included restructuring charges of EUR 16 million. Income from operations in 2001 was impacted by an unfavorable margin mix. In addition, the stronger Polish currency put pressure on margins, as Poland is an important supply base.

Net operating capital

Lighting showed decreased net operating capital at the end of 2002, mainly due to lower receivables and inventories.

Unconsolidated companies

In the LumiLeds Lighting 50/50 joint venture, Philips and Agilent have continued to strengthen the product portfolio of LED-based lighting, one of the key technologies that will drive the lighting business in the future.

Consumer Electronics

amounts in millions of euros	**2002**	2001	2000
Sales	**9,600**	11,052	13,060
% nominal (decrease) increase	**(13)**	(15)	17
Income (loss) from operations*	**230**	(649)	410
as a % of sales	**2.4**	(5.9)	3.1
Income (loss) from operations excl. special items*	**250**	(146)	427
as a % of sales	**2.6**	(1.3)	3.3
Net operating capital	**28**	672	1,486
Employees	**20,080**	31,525	38,726
*) Incl. amortization of goodwill	**–**	(1)	–

Sales

Sales in the Consumer Electronics sector (CE) decreased in 2002 by 13% compared with 2001. A large part of the reduction was due to the shift of former CE activities to the Miscellaneous sector. Sales volume increased by 5%, while price erosion was 10%. The monitor markets experienced a severe price decline, especially in the second half of 2002. The total value of the combined DVD and VCR market declined, DVD (including DVD+RW) showing double-digit growth rates and VCR suffering from being displaced by DVD. Television improved steadily, driven by the introduction of PixelPlus and the extension of the Flat TV product range. The GSM mobile phones business faced challenges in the sell-through of the new product range. Sales at Digital Networks decreased in 2002 by 59% compared to 2001, caused by refocusing the business on a limited number of key accounts as well as poor market conditions.

Sales at Consumer Electronics in 2001 totaled EUR 11,052 million, a decrease of 15% compared with 2000. Sales at Digital Networks dropped by 37% compared to the previous year. The refocus on key customers, combined with a sharply declining market growth rate for set-top boxes, accounted for most of this decrease. The sharp fall in Consumer Communications' sales reflected the scaling-down strategy for GSM mobile phones, which particularly affected sales in Europe.

Income from operations

Income from operations at Consumer Electronics improved considerably in 2002 compared with 2001 and reached a positive level of EUR 230 million.
The total loss of Digital Networks amounted to EUR 71 million, a substantial improvement compared to the loss of EUR 329 million in 2001. Although income from operations of Set-top Boxes showed a major improvement, profitability was not achieved in 2002. The loss-making Philips Broadband Networks was sold in 2002. Digital Transmission Systems was transferred to Miscellaneous. The positive effects of these portfolio changes were about EUR 50 million.
Net restructuring charges in 2002 amounted to EUR 100 million, compared with EUR 503 million in 2001. Restructurings in 2002 included the closure of Monitors' production facilities in Juarez, Mexico (EUR 11 million) and some sites of PCMS (EUR 96 million). The sale of our PCMS activities resulted in a gain of EUR 83 million.

License income in 2002 decreased to EUR 188 million, a reduction of EUR 163 million compared to 2001. Included in 2001 was an amount of EUR 82 million of one-time payments for past use, considerabely higher that the past-use payments received in 2002. The decline can be further attributed to the expiration of basic CD patents in certain countries and regions, which was only partly offset by increased income from our DVD and CD-R/RW licensing programs. The lower US dollar had a negative impact on income.

Income from operations in 2001 decreased to a loss of EUR 649 million, down from a profit of EUR 410 million in 2000. Other than Licenses, which registered higher income due to receipt of prior-year royalties on CD-R licenses, all businesses contributed to the significant decline in income. Restructuring charges of EUR 503 million were recorded during the year 2001. EUR 64 million related to the closure of the VCR factory in Vienna, Austria, in conjunction with the Company's decision to outsource production and to transfer monitor production from Taiwan to China. The loss at Consumer Communications originated mainly from the restructuring charges resulting from the refocusing of the mobile handset business. Income in 2001 was positively impacted by a EUR 41 million insurance payment to compensate for business interruption damage caused by a fire in the semiconductor factory in Albuquerque, USA in 2000. The lower income at Digital Networks included special items for the downsizing and write-off of the Internet and Personal TV business in the USA, as well as restructuring charges at Broadband Networks and Digital Transmission Systems and the cost of development of new technologies at MP4Net, Softworks and CryptoTec.

Net operating capital

Consumer Electronics is continuously reducing the asset base needed for its business operations through optimized supply chain management, an Original Design Manufacturing (ODM) business model philosophy and outsourcing. In the year under review this resulted in a turnover rate of net operating capital of around 20, double the level of three years ago. Inventories were reduced significantly.

Domestic Appliances and Personal Care

amounts in millions of euros	**2002**	2001	2000
Sales	**2,273**	2,224	2,107
% nominal increase	**2**	6	18
Income from operations*	**401**	334	287
as a % of sales	**17.6**	15.0	13.6
Income from operations excl. special items*	**413**	338	300
as a % of sales	**18.2**	15.2	14.2
Net operating capital	**529**	652	752
Employees	**8,766**	9,257	10,111
*) Incl. amortization of goodwill	**–**	(12)	(3)

Sales

Nominal sales increased by 2% in 2002. After adjusting for currency movements, sales increased by 6%, comprising 8% volume growth offset by 2% lower prices. The expansion was above the market growth, due to new product introductions in the various markets coupled with successful regional market penetration (Senseo, Sonicare toothbrush and the new Sensotec shaver). Repositioning of the shaver range in North America had a positive impact on market share. The Senseo has attained the number one position in all countries where it is available.

DAP sales in 2001 grew by 6%, mainly driven by Oral Healthcare in the USA. Lower sales of Male Shaving & Grooming in the USA were offset by a good performance in Europe and steep increases in China. The Food & Beverage business was strongly affected by the adverse market conditions in Latin America.

Income from operations

Income from operations in 2002 increased by 20% to another record level. The improvement was driven by sales expansion, margin improvement due to a better product mix and successful cost-reduction programs. The improvement in profitability was particularly visible in the businesses Oral Healthcare and Food & Beverage.
In 2002, the subsidiary Payer was sold. Payer had approximately 650 employees and production facilities in Austria and Hungary. The effect on income was a loss of EUR 3 million for the transaction.
Restructuring charges in 2002 amounted to EUR 9 million, compared with EUR 4 million in 2001.

Income from operations in 2001 increased by 16% to EUR 334 million, continuing the growth pattern of previous years and defying the adverse market conditions. The successful integration of Optiva, which yielded positive income in the first year after acquisition, contributed to the increased profitability. The launch of Senseo, together with ongoing portfolio rationalization and tight cost control, also contributed to the improvement.

Net operating capital

Net operating capital decreased considerably on a comparable basis. Lower fixed assets as well as a decline in working capital (currently at 40% of the 2000 level) contributed the most to the lower capital base. With increasing sales, the turnover rate came to 4.3 at the end of 2002, up from 3.5 last year.

Components

amounts in millions of euros	**2002**	2001[1])	2000
Sales	**2,212**	2,772	5,042
% nominal (decrease) increase	**(20)**	(45)	23
Segment revenues	**2,450**	3,705	6,920
Income (loss) from operations*	**(329)**	(667)	608
as a % of sales	**(14.9)**	(24.1)	12.1
as a % of segment revenues	**(13.4)**	(18.0)	8.8
Income (loss) from operations excl. special items*	**(244)**	(510)	382
as a % of sales	**(11.0)**	(18.4)	7.6
as a % of segment revenues	**(10.0)**	(13.8)	5.5
Net operating capital	**118**	397	2,158
Employees	**13,005**	15,107	43,546
*) Incl. amortization of goodwill	**–**	(1)	(1)

As a result of the high level of sales of products and services to other Philips product sectors, income from operations is also expressed as a percentage of segment revenues. Segment revenues are the total of sales to third parties and intersegment sales.

[1]) The Display Components business has been deconsolidated effective July 1, 2001, due to the transfer to a joint venture with LG Electronics of Korea.

The performance of Components over the past three years, excluding Display Components, is presented in the following table:

amounts in millions of euros	**2002**	2001	2000
Sales	**2,212**	2,086	3,048
Segment revenues	**2,450**	2,458	3,757
Income (loss) from operations	**(329)**	(529)	448
as a % of sales	**(14.9)**	(25.4)	14.7
as a % of segment revenues	**(13.4)**	(21.5)	11.9

Sales

Components' sales totaled EUR 2,212 million for the year 2002. In nominal terms sales decreased by 20% from 2001, largely due to the deconsolidation of Display Components. On a comparable basis, sales increased by 10%. Sales volume increased by 21%, while average prices declined by 11%.
Mobile Display Systems (MDS) recorded strong growth and gained market share (increased by 7%). The transition to color screens was successfully executed as planned, and revenues from color displays reached close to 45% of total sales by the end of the year. Optical Storage also recorded growth in sales, in spite of overcapacity in the industry as a result of disappointing PC markets. Price erosion intensified and more than offset the volume growth, especially in the commoditized data segment, which led to the decision to downsize this activity. The Audio/Video and Automotive business lines will be continued. Digital Displays had a stable 2002. Creative Display Solutions strengthened its position in the market with expansion of its product portfolio. Sales at Emerging Electronic Solutions grew marginally from the level in 2001, mainly in Sound Solutions. However the performance was weaker in tuners and remote controls.

Sales in 2001 were down at Optical Storage and Mobile Display Systems as a result of the depressed telecommunication and PC-related markets. Sales were negatively impacted by a volume reduction of 19% and price erosion of 10%, as a result of the slowdown in key markets such as personal computers and cellular phones. Sales at Mobile Display Systems declined significantly due to an excess inventory build-up by customers in 2000, which only started to improve in the third quarter of 2001. The optical storage market experienced a severe decline of 32% in 2001.

Income from operations

Income from operations in 2002 came to a loss of EUR 329 million. Special items amounted to a loss of EUR 85 million for the year. Income from operations, excluding all special items, improved by EUR 266 million from the 2001 loss of EUR 510 million, mainly due to a better performance by Mobile Display Systems. Most of the innovative businesses in the Digital Displays cluster are in the early stage of the life cycle, which requires high levels of R&D spending.
The most significant special item related to the charges taken for Optical Storage to exit the data segment, which amounted to EUR 104 million. The decision to dissolve the product division resulted in additional charges of EUR 78 million.
Special items earlier in the year were a gain of EUR 40 million relating to the sale of the Glass activities of Display Components and a EUR 40 million currency translation gain from the liquidation of certain activities in Japan.

The results in 2001 were impacted by special items comprising restructuring costs (EUR 156 million), disentanglement costs related to the transfer of Display Components to the joint venture with LG Electronics (EUR 42 million) and a partial release of EUR 41 million of the provision related to the sale of the Advanced Ceramics & Modules (AC&M) activities in 2000. Restructuring actions at Mobile Display Systems and Optical Storage were taken to realign the cost levels of the organizations to the prevailing market conditions.
Excluding special items, income from operations amounted to a loss of EUR 510 million in 2001, compared to a profit of EUR 382 million in 2000.

Net operating capital

Net operating capital was reduced due to inventory reduction, several asset write-downs and restructuring provisions.

Semiconductors

amounts in millions of euros	**2002**	2001	2000
Sales	**4,089**	4,389	5,879
% nominal (decrease) increase	**(7)**	(25)	55
Segment revenues	**4,613**	4,940	6,812
Income (loss) from operations*	**(537)**	(607)	1,346
as a % of sales	**(13.1)**	(13.8)	22.9
as a % of segment revenues	**(11.6)**	(12.3)	19.8
Income (loss) from operations excl. special items*	**(375)**	(403)	1,344
as a % of sales	**(9.2)**	(9.2)	22.9
as a % of segment revenues	**(8.1)**	(8.2)	19.7
Net operating capital	**3,606**	4,742	4,572
Employees	**31,185**	32,740	35,304
*) Incl. amortization of goodwill	–	(49)	(55)

As a result of the high level of sales of products and services to other Philips product sectors, income from operations is also expressed as a percentage of segment revenues. Segment revenues are the total of sales to third parties and intersegment sales.

Sales

After experiencing the worst downturn in the history of the semiconductor industry in 2001, markets more or less stabilized, although at very depressed levels, in 2002. For the second year in a row, Semiconductors experienced a sales decline, amounting to a nominal 7% in 2002. The decline was experienced across all businesses and consisted of a 7% increase in sales volume, a 3% decline due to currency movements and an 11% decline due to price erosion. On a total available market (TAM) basis, market share declined by 0.1% to 3.1% (Source WSTS). Saturation in the PC and handset markets and a weak financial position of telecom operators and service providers had an adverse effect on semiconductor industry growth. Semiconductors maintained its strong position in the profitable analog markets.

Sales in the Semiconductors sector in 2001 totaled EUR 4,389 million, down 25% compared to the year 2000, despite the 3% positive effect of the acquisition of MiCRUS as of June 1, 2000. Sales volume decreased by 18%, while average prices declined by 10%. The significant decline, which occurred in all business lines and geographic regions, was caused by the slowdown of the world's economies and the PC and telecom markets.

Income from operations

The year 2002 was yet another weak year for the industry. An initial improvement in the first half of the year due to reloading of the inventory channels was not sustained in the second half of the year. Coupled with inventory reductions by our own organizations, this resulted in a still loss-making 54% wafer fab utilization. Expressed as a percentage of segment revenues, income from operations was a loss of 11.6%. Losses were incurred in growth areas such as digital consumer and networking as a result of continued substantial R&D efforts. Excluding net special charges of EUR 162 million, income from operations was a negative EUR 375 million. To reduce overcapacity, it was decided to further downscale production capacity by closing the fab in Albuquerque; this closure will be completed towards the end of 2003. R&D activities and overheads were further streamlined. The total cost of these measures was EUR 169 million in 2002, and a further EUR 66 million will be recognized in 2003. The wafer capacity restructurings announced over the last two years will reduce capacity by 15%.

Income from operations in 2001 included special items of EUR 204 million, consisting of restructuring charges related to the closure of a wafer fab in Albuquerque, USA, the closure of a fab in Caen, France, the reduction of inventory levels and the streamlining of operational costs. Factory utilization was at 40%. Income in 2001 also included EUR 39 million for the settlement of insurance claims for the Albuquerque fire in 2000.

Net operating capital

Capital expenditures were reduced as much as possible. To further limit our exposure to capital commitments, cooperation with TSMC, SSMC and STMicroelectronics will be continued, including a joint 12-inch pilot fab that is being built with STM and Motorola, which is expected to be operational in 2003. Furthermore, net operating capital was reduced mainly due to inventory reduction and several asset write-downs.

Medical Systems

amounts in millions of euros	**2002**	2001	2000
Sales	**6,844**	4,834	3,031
% nominal increase	**42**	59	22
Income (loss) from operations*	**309**	(163)	169
as a % of sales	**4.5**	(3.4)	5.6
Income from operations excl. special items*	**435**	291	213
as a % of sales	**6.4**	6.0	7.0
Net operating capital	**4,849**	5,418	2,821
Employees	**31,027**	30,993	19,358
*) Incl. amortization of goodwill	**–**	(104)	(54)

Sales

Sales at Medical Systems in 2002 totaled EUR 6,844 million, representing 42% nominal growth. Excluding the effects of acquisitions and exchange rate movements, sales increased by 5%. Sales volume increased by 8%, while average prices declined by 3%. X-ray, Computed Tomography, Nuclear Medicine, Cardiac and Monitoring Systems and Customer Support drove the sales increase. From a regional perspective, sales growth was strongest in North America, with modest increases in Asia Pacific and Europe, led by higher sales in Eastern Europe.

Sales in the Medical Systems sector in 2001 totaled EUR 4,834 million, representing 59% growth. Excluding the effects of acquisitions, sales increased by 10%. This was made up of volume growth of 12%, partially offset by price erosion of 3% and positive currency effects of 1%.
All regions achieved positive sales growth, most significantly North America and Europe. In product terms, the main growth areas were Magnetic Resonance, Computed Tomography, X-ray and the Customer Support business.

Income from operations

Income from operations in 2002 amounted to EUR 309 million and included special charges of EUR 126 million, including acquisition-related costs of EUR 84 million and an asset and goodwill impairment charge for Health Care Products (HCP) amounting to EUR 47 million. Excluding these special items and 2001 amortization of goodwill, income from operations in 2002 improved by EUR 40 million to a record EUR 435 million. This increase mainly came from improved sales and performance at X-ray, Customer Service and CT/MR.
Additionally, there were a number of non-recurring charges totaling EUR 73 million, mainly following the Marconi and Agilent acquisitions, and charges taken for the exposure related to Argentina. In addition, IT costs excluding special items were EUR 58 million higher than in 2001, due to the new IT configuration in the acquired companies. Despite a delay and the relatively high cost of integrating IT systems, the integration of the new acquisitions and the related restructuring program are on schedule. Positive synergy effects in 2002 amounted to EUR 173 million. The integration is expected to yield significant savings of EUR 350 million during the full year 2003.

EBITA, excluding special items, non-recurring charges and the HCP activities, came to 9.9% of sales. This equates to 8.1% income from operations as a % of sales excluding special items and non-recurring charges.

Income from operations in 2001 included acquisition-related costs of EUR 379 million, of which in-process R&D write-offs of EUR 106 million and net restructuring charges of EUR 75 million. After the 2001 acquisitions, income included amortization costs for goodwill and other intangibles for an amount of EUR 104 million. Excluding special items and amortization charges, income from operations improved by EUR 128 million. This improvement mainly came from the increase in sales and the success of the product ranges of the Magnetic Resonance and X-ray businesses. MedQuist also contributed to the improvement.

Net operating capital

Net operating capital was significantly lower due to the weaker dollar and the sale of HCP.

Miscellaneous

amounts in millions of euros	**2002**	2001	2000
Sales	**1,957**	1,985	2,974
% nominal (decrease) increase	**(1)**	(33)	18
Income (loss) from operations*	**74**	(104)	(191)
as a % of sales	**3.8**	(5.2)	(6.4)
Income (loss) from operations excl. special items*	**(304)**	(246)	(56)
as a % of sales	**(15.5)**	(12.4)	(1.9)
Net operating capital	**(73)**	314	819
Employees	**14,839**	15,366	18,872
*) Incl. amortization of goodwill	**–**	(3)	(47)

This sector mainly comprises two groups of activities: the central research and technology centers (such as Philips Research, Intellectual Property & Standards, Philips Centre for Industrial Technology and Philips Design) and Corporate Investments (such as Assembléon and Philips Enabling Technologies Group). In addition, there are activities that are being redesigned, or disentangled and readied for sale.

Sales

Sales in the Miscellaneous sector in 2002 came to EUR 1,957 million, a 1% decrease compared to last year. After adjustment for the effects of deconsolidations and currencies, sales were 4% lower than the year before.

Sales in 2001 came to EUR 1,985 million, a 33% decrease on 2000, mainly due to the deconsolidation of FEI, Broadcast and Marantz.

Income from operations

Income from operations in 2002 amounted to EUR 74 million, compared to a loss of EUR 104 million in the previous year. As a consequence of the portfolio rationalization program, the following divestments were effectuated in 2002:
TechnoFusion, SMATV, Heat and Surface Treatment, Philips Broadband Networks, Analytical and CSI. The divestments had a positive effect of EUR 245 million on income from operations and a positive effect of EUR 454 million on cash flow. Furthermore, an earn-out of JDS Uniphase shares, related to the sale of Optoelectronics in 1998, resulted in a gain of EUR 113 million.
Excluding special items, income deteriorated by EUR 58 million, mainly due to a lower level of contract research commissioned by the product divisions, while the long-term corporate funded research remained unaffected. These higher losses were partly offset by improvements at Assembléon and Navigation Technologies. In 2002, total expenditures for R&D activities included in income of the product sectors, mainly Semiconductors followed by Medical Systems, amounted to EUR 3,043 million, representing 9.6% of Group sales, compared to EUR 3,312 million, or 10.2% of Group sales, in 2001 and EUR 2,766 million, or 7.3% of Group sales in 2000.

Income in 2001 benefited from gains on the sale of part of the investment in FEI (EUR 185 million) and the divestment of Philips Broadcast to Thomson Multimedia (EUR 57 million), partly offset by restructuring charges, mainly for PETG and Assembléon, and acquisition-related costs. Excluding special items, income decreased significantly due to operational losses at PETG and Assembléon, which suffered from the downturn in the semiconductor equipment market.

Unallocated

This product sector comprises the costs of the corporate center – including the Company's initial funding of e-business and global brand management programs – as well as country and regional overhead costs. Income from operations amounted to a loss of EUR 330 million in 2002, compared to a loss of EUR 121 million in 2001.
A steep decrease in group overheads in 2002 was offset by significantly higher pension and postretirement benefit costs of EUR 288 million.

Income from operations in 2001 amounted to a loss of EUR 121 million, compared to a loss of EUR 102 million in 2000. A decline in group overheads in 2001 was offset by higher pension and postretirement benefit costs of almost EUR 103 million.

Origin

amounts in millions of euros	2000
Sales	717
% nominal (decrease) increase	(32)
Segment revenues	1,164
Income from operations	1,063
as a % of sales	.
as a % of segment revenues	91.3
Income (loss) from operations excl. special items	(9)
as a % of sales	(1.3)

As a result of the high level of sales of products and services to other product sectors, income from operations is also expressed as a percentage of segment revenues. Segment revenues are the total of sales to third parties and intersegment sales.

In 2000, Origin was merged with Atos. Income in 2000 included a gain of EUR 1,072 million related to this merger.

Sales and income from operations by geographic area

amounts in millions of euros	**2002**		2001		2000	
	sales	income (loss) from operations	sales	income (loss)from operations	sales	income from operations
Europe	**13,250**	**881**	13,920	(487)	16,967	3,246
North America	**9,804**	**(521)**	9,296	(851)	9,565	186
Latin America	**1,513**	**23**	1,918	(13)	2,285	59
Africa	**206**	**7**	237	(10)	271	3
Asia Pacific	**7,047**	**30**	6,968	(34)	8,774	764
	31,820	**420**	32,339	(1,395)	37,862	4,258

Sales

Sales in Europe declined by 5%, partly due to the effect of divestments. Additionally, sales were affected by the weak economy in Germany and by the downsizing of GSM and Digital Networks activities. Semiconductors' sales decreased following weak market demand. DAP and Medical Systems recorded strong sales growth in Europe.
Sales in USA/Canada increased by 5%, attributable to the effect of new consolidations. On the downside, sales suffered from the weaker US dollar and the unfavorable semiconductor market. On a comparable basis, sales developed positively at DAP, Components and Medical Systems.
Sales in Latin America were 21% lower, following the collapse of the Argentinian and Venezuelan economies and the impact thereof on the region. All sectors were affected.
Sales in Asia Pacific increased by 1%, hampered by the negative effect of deconsolidations (2%) and weaker currencies (5%). On a comparable basis, sales expanded by 8%, headed by strong growth in China and South Korea of 26% and 22% respectively. Excluding the effects of changes in consolidations and currencies, sales developed positively at Lighting, Components, Semiconductors and Medical Systems. Lower sales were posted in the Consumer Electronics sector, especially in GSM and Licenses.

Income from operations

The improvement in income from operations on a global level was also visible in the performance of the various regions. All regions improved their profitability, especially Europe and North America.
Despite the considerable improvement in North America, this region is still loss-making, due to restructuring charges at Semiconductors, Components and CE and acquisition-related charges at Medical Systems. All other regions were profitable.

Restructuring and impairment charges

The ongoing difficult operating environment in 2002, together with overcapacity in certain business areas, required a number of restructuring measures. In 2002 further progress was made in bringing our portfolio into line with our ambitions and we took measures to develop a more flexible cost base. This, combined with the ongoing process of efficiency improvement, has led to restructuring and impairment charges, for various projects, of EUR 513 million, net of releases.

The most significant new projects in 2002 were:

- Dissolution of the Components division (EUR 78 million) in order to reduce costs and simplify the organizational structure. This will further streamline innovation and create more value through better alignment of related businesses currently positioned in different divisions.
- Rationalization of the product portfolio of Optical Storage (EUR 104 million) to restore profitability by concentrating on the areas where it can add most value, e.g. innovating, defining and establishing new standards for data storage.
- Reduction of excess capacity at Semiconductors (EUR 180 million) in order to lower the break-even level and bring capacity into line with demand.
- Reduction of manufacturing capacity of PCMS at Louviers, Juarez and Hasselt (EUR 96 million).
- Closure of Consumer Electronics' monitor production facilities in Mexico (EUR 11 million) and their transfer to Asia due to continued price pressures in OEM and branded markets and a rapidly declining CRT monitor market in North America and Europe.
- Reduction of Research activities in France (EUR 12 million).
- Several programs at Lighting (EUR 20 million).
- HCP asset and goodwill impairment (EUR 47 million).

Restructuring and impairment charges in 2001 amounted to EUR 1,093 million, consisting of EUR 1,120 million for projects at Consumer Electronics, Semiconductors, Components, Digital Networks, Medical Systems and Miscellaneous, partly offset by releases of EUR 27 million.

In 2000, projects were started at Consumer Electronics, Components, Lighting and Miscellaneous, for an amount of EUR 243 million, partly offset by releases of EUR 46 million. Individually, the largest projects in 2000 were the closure of the large-screen operations of Hosiden and Philips Display (HAPD) in Kobe, Japan, and the Components activities in Germany and Taiwan.

Total gross restructuring and impairment charges in 2002, 2001 and 2000 can be categorized as follows:

amounts in millions of euros	**2002**	2001	2000
Personnel lay-off costs	**245**	437	125
Write-down of assets	**214**	240	47
Other costs	**103**	136	26
Restructuring charges	**562**	813	198
Impairment goodwill	**19**	–	35
Write-down of inventories (in cost of sales)	**10**	307	10
Total restructuring and impairment	**591**	1,120	243
Release of restructuring provisions	**78**	27	46

In 2002, releases of surplus provisions amounted to EUR 78 million. They were primarily related to Miscellaneous, Consumer Electronics, Components, Semiconductors and Lighting, and were for the greater part caused by reduced severance payments.

Releases of surplus restructuring provisions in 2001 totaled EUR 27 million. The releases were primarily related to Lighting and Components.

In 2000, releases of surplus provisions amounted to EUR 46 million, due to lower expenditures on completed projects, and were related to all sectors except Domestic Appliances and Personal Care and Unallocated.

Restructuring projects started in 2002 will lead to a headcount reduction of approximately 6,700, of which 3,900 relate to direct labor and 2,800 to indirect labor (total lay-offs in 2001 approximately 10,800 persons, and in 2000 approximately 5,000 persons).

In general, restructuring plans lead to cash outflows in the year in which they are recognized and in the following years, and are financed from the normal cash flow from operations. Estimated cash outflows relating to projects started in 2002 and previous years can be summarized in the following table:

amounts in millions of euros	total charges					of which
		non-cash	cash 2000	cash 2001	cash 2002	cash 2003*
Restructuring 2002	562	316			21	225
Restructuring 2001	813	267		124	235	187
Restructuring 2000	198	47	106	45		

* Future cash outflows are based on estimates.

Philips' share in restructuring and impairment charges recognized by unconsolidated companies amounted to EUR 301 million and as such is included in the results relating to unconsolidated companies.

For further details of restructuring charges, see notes 2 and 5 to the consolidated financial statements.

Financial income and expenses

Financial income and expenses amounted to a net expense of EUR 2,227 million in 2002, compared to an expense of EUR 915 million in 2001 and income of EUR 1,993 million in 2000. Net interest expenses amounted to EUR 384 million in 2002, compared with EUR 391 million in 2001 and EUR 167 million in 2000. The net interest expenses in 2002 were lower than in 2001, mainly due to lower interest rates. In 2000, net interest expenses were lower, mainly as a result of the lower net debt level of the Group.

Financial income in 2002 included a gain of EUR 67 million from the partial sale of shares in ASML. During the year 2000 the Company sold a portion of the JDS Uniphase shares that had been received upon the sale of Philips Optoelectronics in 1998. The gain from the sale amounted to EUR 1,207 million. Moreover, in 2000, Seagram shares were exchanged for shares of Vivendi Universal. The gain from the exchange of Seagram shares amounted to EUR 1,115 million in 2000, net of US dollar hedge and taxes.

In view of the extended period of time over which the market value of security investments in Vivendi Universal, GN Great Nordic and JDS Uniphase was below book value, these shares were written down to fair value. The market value of these securities at year-end 2002 was EUR 589 million, EUR 19 million and EUR 117 million respectively. The related recognized impairment losses were EUR 1,855 million, EUR 27 million and EUR 73 million respectively. In 2001, the impairment losses came to EUR 440 million for Vivendi Universal and EUR 86 million for GN Great Nordic.

In addition, as in 2001, in 2002 dividends totaling EUR 33 million were received on the Vivendi Universal shares, while in 2000 dividends totaling EUR 32 million were received on the Seagram shares.

Income tax

The income tax expense totaled EUR 27 million in 2002, compared with a tax benefit of EUR 428 million in 2001 and an expense of EUR 563 million in 2000. This corresponds to an effective tax rate of negative 1% in 2002, as compared to 18% in 2001 and 9% in 2000. Excluding the non-deductible charges for impairment of securities, the effective tax rate in 2002 would amount to 18%. For the coming year the Company expects an effective tax rate of around 25%. The effective tax rate for 2001 was affected by non-deductible charges for impairment of securities of 6%, whereas the effective tax rate for 2000 was influenced by tax-exempt proceeds from the sale of various securities (tax effect 13%). Please refer to note 4 of the consolidated financial statements.

Results relating to unconsolidated companies

Results relating to unconsolidated companies amounted to a loss of EUR 1,346 million in 2002, compared to a loss of EUR 608 million in 2001 and a profit of EUR 3,956 million in 2000. The composition of these results is as follows:

amounts in millions of euros	**2002**	2001	2000
Income (loss) excl. amortization of goodwill and other intangibles and special items	**291**	(103)	683
Amortization of goodwill and other intangibles	**(24)**	(257)	(124)
Special items:			
- restructuring and impairment charges	**(1,606)**	(208)	–
- gain on sale of shares	**5**	20	2,717
- equity dilution (losses) gains TSMC	**(12)**	(60)	680
	(1,346)	(608)	3,956

In general, operational results at unconsolidated companies in 2002 improved compared to 2001. The operational performance of LG.Philips LCD improved due to a strong overall LCD market with significantly better price levels, particularly in the first half of 2002, and much higher volumes.
Taiwan Semiconductor Manufacturing Company (TSMC) maintained profitability despite suffering from declining markets in the second half of 2002. Its utitilization rate slipped to 61% in the last quarter. TSMC still outperforms the semiconductor industry as a whole, because of the increased outsourcing by electronics companies.
LG.Philips Displays' income was negatively impacted by restructuring and asset impairment charges of EUR 301 million. These restructurings were carried out to transfer operations to lower cost regions.
Furthermore, Philips has determined that the present value of the future net cash flows of LG.Philips Displays is not sufficient to cover the carrying value of Philips' investment in the joint venture. An impairment charge of EUR 275 million was recognized in this respect. The investment in Atos Origin was also written down by EUR 921 million as a consequence of the other-than-temporary decline of the Atos Origin share price.
The results relating to unconsolidated companies included amortization of goodwill of EUR 24 million that was related to Atos Origin's fourth quarter of 2001 due to the fact that their results are reported on a three-month delay basis. Excluding amortization costs and special items, Philips' share in the results of these companies improved by EUR 394 million.

The unfavorable results in 2001 compared to 2000 were primarily attributable to a deterioration in the performance of virtually all of our major unconsolidated companies. TSMC, LG.Philips LCD and LG.Philips Displays were affected by overcapacity and the severely depressed telecom and PC-related markets, resulting in sharp price erosion and low sales volumes. Results in 2001 also reflect full-year goodwill amortization of Atos Origin. Excluding special items and amortization of goodwill and other intangibles, Philips' share in the 2001 results of TSMC and the two joint ventures with LG Electronics of Korea amounted to a profit of EUR 180 million and a loss of EUR 211 million respectively.

The 2001 results were affected by several special items. The employee bonus stock option program of TSMC had the effect of diluting Philips' shareholding in the company, resulting in a loss of EUR 60 million. Additionally, the results of TSMC included a charge for impairment of EUR 82 million. Restructuring charges at LG.Philips Displays of EUR 89 million and the write-down of certain Corporate Venturing investments totaling EUR 37 million also impacted earnings. That year's income was positively affected by a gain of EUR 20 million resulting from the sale of the Company's stake in Philips Matsushita Battery Corporation.

Income in 2000 contained a significant amount of special items, of which the gain on the sale of a portion on ASML shares was the most significant. Excluding these items, income of TSMC and ASML was positively influenced by the favorable semiconductor market. LG.Philips LCD also contribued to income. This was partly offset by losses of SSMC and LumiLeds, both of which incurred high start-up costs.

Cooperative business activities and unconsolidated companies

Philips engages from time to time in cooperative activities with other companies. Philips' principal cooperative business activities and participating interests are set out below.

Taiwan Semiconductor Manufacturing Company Limited (TSMC) is a semiconductor foundry operation in which Philips currently holds 21.7% of the total number of outstanding common shares. In November 2000 the Company purchased redeemable preferred shares, bringing its total holding in TSMC to approximately 27.0%. These preferred shares are redeemable in the second quarter of 2003. The principal reasons for this shareholding are to secure a strategic supply of wafers, to share and exchange technology and manufacturing knowledge, and to save capital.

Systems on Silicon Manufacturing Company (SSMC) is a Singapore-based wafer fabrication firm established by Philips (48%), TSMC (32%) and the Economic Development Board of Singapore (20%). The principal reasons for the shareholding are to secure a strategic supply of wafers and to limit loading risks and save capital.

Atos Origin is a leader in end-to-end business and e-business solutions. The company is operational in 30 countries. Philips currently holds a 48.4% stake in Atos Origin. As from 2002, Philips may reduce its stake in the combined entity to below 35%, subject to market conditions being acceptable. There are no current plans to do so. Philips has also received two tranches of stock warrants, each representing approximately 2.4 million Atos Origin shares, which may be exercised only on certain conditions, subject to the appreciation of the Atos Origin share price to specified levels. The latter is not likely to occur. One tranche of stock warrants expired in 2002.

LG.Philips LCD Co. is a 50/50 manufacturing joint venture with LG Electronics of South Korea and is one of the top two suppliers of TFT liquid-crystal displays in the world. This joint venture has enabled Philips to become a leading company in the area of active-matrix LCDs, a display technology that is rapidly migrating from notebook displays to desktop monitors, and in the near future to other areas, including television.

LG.Philips Displays is a 50/50 joint venture with LG Electronics of South Korea and is a leading supplier in its line of business. The joint venture combines the two companies' complementary strengths and creates a strong synergy potential in the mature CRT display market. The joint venture is in the midst of a large restructuring program intended to reduce its operational costs.

In the LumiLeds Lighting 50/50 joint venture, Philips and Agilent have the complementary strengths and positions to successfully develop the market for LED-based lighting products. Both companies have expanded the scope of their existing activities. Both parties hold equal shares in the venture, whose product portfolio has been extended from LED traffic signal products to a variety of other applications, including automotive, signaling, contour lighting and signs, illumination and LCD backlighting, demonstrating both parties' confidence in the new technology. At year-end 2002, the operations were located in the USA, Malaysia and the Netherlands.

FEI Company is a US-based company in which Philips holds 26% of the outstanding shares. FEI is the leading supplier of Structural Process Management ™ solutions to the world's technology leaders in the fields of semiconductors, data storage and biological structures.

Philips Medical Capital is a joint venture with Rabobank Group's subsidiary De Lage Landen International, in which Philips holds a 40% interest. The venture provides financing for the purchase of diagnostic imaging equipment produced by Philips Medical Systems throughout the United States.

By year-end 2002 the Corporate Venturing portfolio comprised some 25 companies in which Philips has both a minority stake and a business relationship. The Company has stopped acquiring interests in new ventures.

Minority interests

In 2002, the share of minority interests in the income of group companies amounted to EUR 26 million, compared with a share in the loss of EUR 15 million in 2001 and a share in income of EUR 67 million in 2000. The change in income in 2002 is mainly attributable to excess dividends received in 2001, relating to minority shareholdings, which did not occur in 2002. The change in 2001 compared to 2000 is mainly attributable to the consolidation of NavTech and deconsolidation of FEI in 2001 and some buy-outs of minority shareholdings.

Net income

Income before the cumulative effect of change in accounting principle amounted to a loss of EUR 3,206 million (EUR 2.51 per common share – basic), compared to a loss of EUR 2,475 million in 2001 (EUR 1.94 per common share – basic) and income of EUR 9,577 million (EUR 7.30 per common share – basic) in 2000.

There were no extraordinary items in the year under review or the previous two years.

Income of EUR 85 million was recorded in 2000 as a cumulative effect of change in accounting principle for derivative instruments, representing the changes in value of foreign-exchange contracts relating to hedges of securities.

Net income in 2002 amounted to a loss of EUR 3,206 million (EUR 2.51 per common share – basic), compared to a loss of EUR 2,475 million in 2001 (EUR 1.94 per common share – basic) and income of EUR 9,662 million (EUR 7.36 per common share – basic) in 2000.

Liquidity and capital resources

Net operating capital per sector

	2002	2001	2000
Lighting	1,723	1,979	1,903
Consumer Electronics	28	672	1,486
DAP	529	652	752
Components	118	397	2,158
Semiconductors	3,606	4,742	4,572
Medical Systems	4,849	5,418	2,821
Miscellaneous	(73)	314	819
Unallocated	(241)	135	(141)
Total	10,539	14,309	14,370

Cash flows

Cash flows provided by operating activities totaled EUR 2,228 million in 2002, compared with EUR 1,248 million in 2001 and EUR 2,996 million in 2000. The increase in cash provided by operating activities is attributable to the further reduction of working capital in relation to sales. This reflects the success of the cash conversion cycle program and effective supply chain management in most sectors. Expressed as a percentage of sales, inventories ended at an all-time low of 11.1%, compared with 13.3% at the end of 2001 and 13.9% at the end of 2000. Outstanding trade receivables at year-end 2002 were the equivalent of 1.3 months' sales, compared to 1.5 months at the end of both 2001 and 2000. More standardized credit terms have been agreed with our suppliers.

Cash flows from investing activities required EUR 248 million in 2002, EUR 4,564 million in 2001 and EUR 2,404 million in 2000.
In 2002, gross capital expenditures were scaled back to EUR 1,161 million as we aligned our component and semiconductor manufacturing facilities to the lower level of market demand. In 2001, capital expenditures came to EUR 2,143 million and were significantly down from the level of EUR 3,170 million in 2000. In 2002 the ratio of gross investments to depreciation came to 0.7, compared to 1.1 in 2001 and to 1.8 in 2000.
During the year 2002, EUR 626 million was used for the purchase of businesses and investment in unconsolidated companies. EUR 250 million was used for a settlement associated with the establishment of the joint venture LG.Philips Displays, including a subsequent cash injection. Additionally, a final payment of EUR 90 million was made to Agilent in respect of the 2001 acquisition of HSG. A capital injection in Systems on Silicon Manufacturing Company (SSMC) of EUR 69 million and also a number of smaller investments were made. These outflows were fully offset by proceeds from the sale of various businesses in 2002 totaling EUR 813 million; primarily the sale of Philips Contract Manufacturing Services (PCMS), Analytical, Communication, Security and Imaging (CSI), the HCP group of Medical Systems, Philips Broadband Networks and TechnoFusion. Furthermore, the final instalment of the 2001 sale of Philips Broadcast of EUR 63 million was collected. In addition, EUR 422 million was received from the resetting of currency swap transactions, while proceeds from the sale of shares (of which ASML shares of EUR 72 million) amounted to EUR 98 million.

During the year 2001, Philips invested EUR 3,636 million in businesses operating in strategic areas to further strengthen its global market position. The investments included the purchase of the assets of the Healthcare Solutions Group of Agilent (EUR 1,943 million) and the acquisition of the medical systems activities of Marconi for EUR 1,245 million. In 2001, LG Electronics redeemed its 7.5% redeemable preferred shares. This redemption resulted in a cash inflow of EUR 486 million. In addition, EUR 200 million was generated by the sale of a portion of the shares in FEI and the repayment by FEI of loans from Philips. Furthermore, EUR 295 million was generated by the sale of the Glass business to LG.Philips Displays.

During the year 2000, Philips invested EUR 3,209 million in businesses. The investments included the purchase of a 71% majority interest in MedQuist (EUR 1,339 million), the acquisition of Optiva Corporation (EUR 291 million), payments for the acquisition of MiCRUS (EUR 228 million), the purchase of ADAC (EUR 437 million), the purchase of 3.5% redeemable preferred shares in TSMC (EUR 458 million) and investments in a number of smaller Corporate Venturing and other businesses (EUR 126 million and EUR 330 million respectively). Moreover, Philips invested EUR 505 million in the purchase of 7.5% redeemable preferred shares of LG Electronics. The divestment of Philips' AC&M business yielded a net amount of EUR 658 million in cash. A positive cash flow of EUR 2,710 million was generated by the sale of 16.5% of the shares in ASML. Furthermore, an amount of EUR 1,272 million was generated by the sale of a portion of the JDS Uniphase shares.

As a result of the items mentioned above, cash flows before financing activities were a positive EUR 1,980 million in 2002 compared with a negative EUR 3,316 million in 2001 and a positive EUR 592 million in 2000.

In 2002 net cash used for financing activities amounted to EUR 897 million. This included the issuance of a EUR 300 million eurobond in August, the proceeds of which were used for repayment of short-term debt. Philips shareholders were paid a distribution in cash totaling EUR 459 million. Treasury stock was purchased for an amount of EUR 19 million.

In 2001 net cash flows provided by financing activities amounted to EUR 3,159 million. This includes EUR 4,250 million from the issuance of two tranches of two bonds each and EUR 521 million from the issuance of commercial paper. Philips shareholders received dividends of EUR 458 million. Treasury stock transactions totaled EUR 336 million.

In 2000 the net cash flows used for financing activities amounted to EUR 2,038 million, of which EUR 1,673 million was used for a 3% share reduction program. Additionally, EUR 612 million was used to repay interest-bearing debt and EUR 399 million was used for the payment of dividends to Philips shareholders. Furthermore, treasury stock transactions required EUR 578 million.

Financing

Total debt outstanding at the end of 2002 was EUR 7,109 million, compared with EUR 7,866 million at the end of 2001 and EUR 4,027 million at the end of 2000.

Changes in long-term debt are as follows:

amounts in millions of euros	2002	2001
• New borrowings	405	4,580
• Repayments	(276)	(554)
• (Decrease) increase current portion	(15)	293
• Consolidation and other effects	(217)	(8)
	(103)	4,311

In 2002, long-term debt was reduced by EUR 103 million to EUR 6,492 million. During 2002, Philips issued new long-term debt for EUR 300 million. During 2001, Philips issued four new bonds for a total amount of EUR 4,250 million. Two outstanding bonds matured during 2001 for a total amount of EUR 441 million.

Philips had two 'putable' USD bonds outstanding at year-end 2002 for a total amount of EUR 256 million. The investors may require repayment in one specific month during the lifetime of the respective bonds. Assuming that investors require repayment at the relevant put dates, the average remaining tenor of the total outstanding long-term debt was 4.2 years, compared to 5.2 years in 2001. However, assuming that the 'putable' bonds will be repaid at maturity, the average remaining tenor at the end of 2002 was 4.9 years, compared to 6.1 years at the end of 2001. Long-term debt as a proportion of the total debt at the end of 2002 stood at 91%, compared to 84% at the end of 2001.

Changes in short-term debt are as follows:

amounts in millions of euros	2002	2001
• Net borrowings (repayments)	(548)	(73)
• Increase (decrease) current portion long-term debt	15	(293)
• Consolidation and other effects	(121)	(106)
	(654)	(472)

In July 2002, Philips closed a USD 3.5 billion revolving credit facility. The facility, which has a five-year maturity, replaces an existing USD 2.5 billion revolving credit facility, which had been in place since July 1996 and was never drawn upon by the Company. The new revolving credit facility also had no drawings in 2002. At the beginning of 2001, Philips established a global commercial paper program totaling USD 2.5 billion. Under this program the outstanding amounts reached a maximum of EUR 734 million during the year, while at year-end EUR 10 million was outstanding. Part of the previously mentioned standby credit facility acts as a back-up for the global commercial paper program.

Cash and cash equivalents increased by EUR 968 million in 2002 to EUR 1,858 million. Currency impacts and consolidation changes had a negative effect of EUR 115 million. In 2001, cash and cash equivalents declined by EUR 199 million to EUR 890 million at year-end. Currency impacts and consolidation changes accounted for a EUR 42 million decrease.

The Company had a net debt position (debt, net of cash and cash equivalents) of EUR 5,251 million at the end of 2002. The net debt position at the end of 2001 amounted to EUR 6,976 million and at the end of 2000 to EUR 2,938 million. The net debt to group equity ratio amounted to 27:73 at the end of 2002, compared to 26:74 at the end of 2001 and 11:89 at the end of 2000.

Stockholders' equity decreased by EUR 5,241 million to EUR 13,919 million at year-end 2002, which was mainly due to the net loss of EUR 3,206 million in 2002. Currency translation differences in equity resulted in a decrease of EUR 946 million, while the deferred results – net of taxes – of financial derivative transactions within equity increased equity by EUR 18 million. Equity was also reduced by treasury stock transactions of EUR 13 million and by payments to shareholders of EUR 459 million from the retained earnings related to prior financial year.
Insofar as not recognized as impairment charges under income, the lower fair market value of securities available for sale compared to their book value at the beginning of the year was recorded under other comprehensive income and reduced equity by EUR 301 million. Furthermore, the sharp decrease in the stock markets in 2002 resulted in additional liabilities for pensions. A major part of these additional pension liabilities had to be reported within other comprehensive income as a reduction of equity. The charge to other comprehensive income in 2002 (net of taxes) because of these additional pension liabilities amounted to EUR 335 million for pension funds in the USA and UK.

The EUR 3,547 million decrease in equity in 2001 was mainly due to the 2001 net loss of EUR 2,475 million.

The number of outstanding common shares of Royal Philips Electronics at December 31, 2002 was 1,276 million (2001: 1,274 million shares).

At the end of 2002 the Group held 40.1 million shares in treasury to cover the future delivery of shares in conjunction with the 67.0 million conversion and stock option rights outstanding at the end of 2002. At year-end 2001, 41.9 million shares were held in treasury against a 50.1 million rights overhang. It has been the Company's policy to hedge part of its option grants.

Capital resources

Philips is of the opinion that it has adequate financial resources to finance working capital needs. Furthermore, the Company has no material commitments for capital expenditures. Of Philips' USD 2.5 billion commercial paper program, EUR 10 million was outstanding as of December 31, 2002. Short-term bank borrowings, excluding the current portion of long-term debt, totaled EUR 412 million as of that date. In July, Philips closed a USD 3.5 billion revolving credit facility. The facility, which has a five-year maturity, replaces an existing USD 2.5 billion revolving credit facility which had been in place since July 1996 and was never drawn upon by the Company. This syndicated bank facility has not required financial covenants and does not have credit-rating-related acceleration possibilities or any availability restrictions. In June 2002 Philips filed a Shelf Registration Statement (Form F-3) with the Securities and Exchange Commission. This filing gives Philips the flexibility to issue debt securities and/or to set up a US Medium Term Notes program for an amount up to USD 2.5 billion.
The Company's total debt as of year-end 2002 was EUR 7,109 million, of which EUR 617 million was short-term. With year-end cash balances of EUR 1,858 million, net debt was EUR 5,251 million. In view of the Company's EUR 6.8 billion shareholdings in affiliates and other companies and the USD 3.5 billion revolving facility mentioned above, the Company's liquidity position is strong.

Off balance sheet arrangements

Philips has guaranteed up to USD 200 million debt of its subsidiary LG.Philips Displays (with matching guarantee granted by the other shareholder, LGE). The guarantee, expiring on December 31, 2004 or earlier, is related to loans of LG.Philips Displays, which in turn have provisions for acceleration linked to minimum financial ratio covenants.

In November 2002, the Company and Jabil Circuit Inc., a global leader in Electronic Manufacturing Services (EMS), agreed on the sale of most of Philips Contract Manufacturing Services (PCMS). Under the terms of the agreement, Jabil acquired the manufacturing operations on three continents, including sites in Austria, Belgium, Brazil, China, Hungary, India, Poland and Singapore. From these locations, Jabil will continue to provide key components for the manufacture of a wide range of Philips products, including televisions, DVD and audio systems, storage and display products and set-top boxes under a four-year, four-billion euro product supply agreement (refer to note 1).

Contractual obligations and commercial commitments

Contractual cash obligations					payments due to period
(in millions of euros)	total	less than 1 year	2-3 years	4-5 years	after 5 years
Long-term debt	6,679	193	2,994	397	3,095
Capital lease obligations	8	2	4	1	1
Short-term debt	422	422	–	–	–
Operating leases	879	166	277	205	231
Total contractual cash obligations	7,988	783	3,275	603	3,327

N.B. Unconditional purchase obligations incurred in the normal course of business have not been quantified.

Other commercial commitments				expiration per period
(in millions of euros)	total amounts committed	less than 1 year	2-5 years	after 5 years
Stand-by letters of credit *	3,339	–	3,339	–
Guarantees**	906	278	577	51
Total commercial commitments	4,245	278	3,916	51

* No amounts drawn
** Refer to note 25

Proposed distribution to shareholders of Royal Philips Electronics

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 from the other reserves as indicated in the balance sheet under Dutch GAAP (retained earnings under US GAAP) (2001: a distribution was made of EUR 0.36 per common share).
The balance sheet presented in this report, as part of the consolidated financial statements for the period ended December 31, 2002, is before distribution, which is subject to shareholder approval after year-end. Adoption of the proposal by the General Meeting of Shareholders will result in a total cash payment in the year 2003 and a reduction of the retained earnings by EUR 459 million (compared with EUR 459 million in 2002).

Employment

The number of employees at the end of December 2002 totaled 170,087, a decline of 18,556 from December 31, 2001. Part of the reduction of 9,514 was caused by various consolidations changes. The largest ones were PCMS (4,460), HCP (927), CSI (1,311), Analytical (790) and Broadband Networks (438). On a comparable basis, the reduction was 9,042 employees, mainly centered on Consumer Electronics, Semiconductors and Corporate Investments. The headcount at Medical Systems increased by 846 persons as a result of expanding activities.
In geographic 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 R&D area was affected to a lesser extent.

thousands of employees

	2002	2001	2000
Nominal position, at year-end	**170.1**	188.6	219.4
Consolidation changes:			
- new consolidations	**0.4**	15.5	10.0
- deconsolidations	**(9.9)**	(27.7)	(20.7)
Comparable changes	**(9.0)**	(18.6)	3.2

Other issues

New accounting standards becoming effective in 2003 are described in detail on page 57.

Risk factors

Philips is a global company, which means that it is affected by economic developments in all regions of the world. In addition to the risks inherent to its operations, Philips is exposed to specific market and financial risks. In the following paragraphs, a summary of Philips' approach towards risk management and a brief description of the nature and the extent of its exposure to risks are given. The risk overview provided is not exhaustive. Some risks, not yet known to Philips or currently believed not to be material, could later turn out to have a major impact on Philips' businesses, revenues, income, assets, liquidity or capital resources.

The risk factors should be considered in connection with any forward-looking statements.

Risk management approach

Risk management forms an integral part of business management. The Company's risk and control policy is designed to provide reasonable assurance that strategic objectives are met by creating focus, by integrating management control over the Company's operations, by ensuring compliance with legal requirements and by safeguarding the reliability of the financial reporting. It makes management responsible for identifying the critical business risks and the implementation of fit-for-purpose risk responses. Structured self-assessments are used company-wide to identify, assess and effectively respond to business risks and to monitor compliance with minimum control standards in order to ensure reliable financial reporting. In addition, internal and external auditors, as part of their annual financial statements audit, review the quality of the control system and adherence to the Company's risk and control policy.

Accountability is enforced through the formal issuance of a Statement on Business Controls and a Letter of Representation by each business unit, resulting, via a cascade process, in a statement by each product division. The outcome of the self-assessment process and the reviews by internal and external auditors, and the Statement on Business Controls and Letter of Representation, are subject to review by the Board of Management. From 2003 onwards, the existing internal assurance process for business risk assessment will be further strengthened and the review frequency will be upgraded to a quarterly review cycle, in line with emerging best practices in this area.

Internal audit committees at product division and business level meet on a regular basis to address weaknesses in the business control infrastructure as reported by the internal and external auditors and to take corrective action where necessary. They are also involved in determining the desired internal audit coverage.
The Company's CEO and CFO personally review the establishment and maintenance of proper internal controls in the product divisions and major staff and service functions. The quality of the Company's system of internal controls and the results of internal and external audits are reported to and discussed in the Audit Committee of the Supervisory Board.

Standard norms and values for 'doing business' applicable to all our employees and business partners are laid down in the Philips General Business Principles and enforced by a global system of Compliance Officers.

Market risks

Philips is active in more than 60 different businesses with different risk profiles, which are geared to the business environment in which they operate and the competitive advantage they aim to achieve.
Depending on the nature of the activity, the risk profile of Philips' businesses is diverse. Some, like Lighting and Domestic Appliances and Personal Care, are active in more stable markets. Others, like Semiconductors, operate in highly cyclical markets and may experience substantial period-to-period fluctuations in their results as a consequence of changes in industry conditions, economic conditions or other factors.

During 2002, Semiconductors continued to suffer from adverse economic conditions, characterized by reduced product demand, high price erosion and overcapacity in manufacturing. In line with the development of the demand patterns, Semiconductors has undertaken considerable initiatives to reduce capacity and to reduce operational costs in order to restore profitability. These restructurings and cost-reduction targets will continue to require management attention. To achieve sustainable growth, in particular in the digital markets, effective and controlled R&D is critical to the success of this business.

From 2003 onwards Components ceases to exist as a separate product division. The former Components businesses will be partly integrated in Consumer Electronics and Semiconductors and partly allocated to Miscellaneous for redesign, redevelopment and/or sale. The complex restructuring, integration and divestment process will require substantial management attention in 2003.

The consumer electronics businesses in which Philips is engaged are intensely competitive. Accordingly, Philips continually faces competitive challenges such as rapid technological change, evolving standards, shortening product life cycles and price erosion. Initiatives to reduce assets through outsourcing will require increased management focus with respect to the supply base. The realization of a world-class performance in supply chain management is critical for success in the global consumer electronics industry.

During 2002, Medical Systems undertook major efforts to integrate its recent acquisitions into the existing businesses and reap the benefits. Although we are seeing encouraging progress, the integration and the alignment of business processes, systems, procedures and internal controls will continue to require substantial management attention, also during 2003. Continuous improvement of the delivery performance for both system deliveries and customer services is a critical success factor in meeting the challenges of competition.

Philips operates in high-tech markets with rapid technological development which require the Company to make large financial investments. Philips continues to utilize partnerships in order to share the risks associated with large investments. These partnerships take place through minority shareholdings, joint ventures and majority shareholdings. Managing this growing number of strategic alliances, and in particular bridging the international, legal and cultural differences, is a growing risk in itself. In addition, Philips may face conflicts of interests, loss of control over cash flows and loss of proprietary technologies by participating in joint ventures.

Philips' longer-term success depends on technological innovation, global standards and its ability to obtain and retain licenses and other intellectual property rights covering its products and its design and manufacturing processes. The process of seeking intellectual property protection can be long and expensive. Competitors and other third parties may also develop technologies that are protected by patents and other intellectual property rights. These technologies may therefore not be available to Philips or may be made available to Philips only on unfavorable terms and conditions.

Further globalization and concentration of our customer and supply base makes Philips increasingly dependent on a limited number of business partners, posing challenges to existing management and control structures in many of our businesses.

A critical risk area that has our attention is human resources. The retention of highly specialized technical personnel as well as talented employees in sales and marketing, research and development, finance and general management, is critical for the success of the Company.

Being a global company, Philips has established subsidiaries in over 60 countries. The subsidiaries are exposed to changes in governmental regulations and unfavorable political developments, which may limit the realization of business opportunities or impair local Philips investment.

Financial risks

Currency fluctuations may impact Philips' financial results. Furthermore, Philips is exposed to interest rate risk, commodity price risk, equity price risk and credit risk. For qualitative and quantitative disclosure about financial risks, please refer to note 30 of the consolidated financial statements.

Critical Accounting Policies

The preparation of Philips' financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. The policies that management considers both to be most important to the presentation of Philips' financial condition and results of operations and to place the most significant demands on management's judgments and estimates about matters that are inherently uncertain are discussed below. Management cautions that future events often vary from forecasts and that estimates routinely require adjustment.
A complete description of Philips' accounting policies appears on pages 49 through 57.

Intangible assets acquired in business combinations

Over the past few years the Company has acquired several other entities in business combinations that have been accounted for by the purchase method, resulting in recognition of substantial amounts of in-process research and development, goodwill and other intangible assets. The amounts assigned to the acquired assets and liabilities are based on assumptions and estimates about their fair values. In making these estimates, management typically consults independent qualified appraisers. A change in assumptions and estimates would change the purchase price allocation, which could affect the amount or timing of charges to the income statement, such as write-offs of in-process research and development and amortization of intangible assets. In-process research and development is written off immediately upon acquisition, whereas intangible assets (and prior to 2002 also goodwill) are amortized over their economic lives. As a result of Philips' adoption of US GAAP as of January 1, 2002, goodwill is no longer amortized but instead is tested for impairment.
Changes in assumptions and estimates included in the purchase price allocation could result in significantly different results than those recorded in the financial statements.

Impairment

Philips reviews long-lived assets for impairment when events or circumstances indicate that carrying amounts may not be recoverable. Assets subject to this review include equity and security investments and intangible and tangible fixed assets.
Impairment of equity and security investments results in a charge to income when a loss in the value of an investment is deemed to be other than temporary. Management regularly reviews each equity and security investment for impairment based on the extent to which cost exceeds market value, the duration of decline in market value and the financial condition of the issuer.

In determining impairments of intangible and tangible fixed assets, management must make significant judgments and estimates to determine whether the undiscounted cash flows generated by those assets are less than their carrying value. Determining undiscounted cash flows requires the use of judgments and estimates that have been included in the Company's strategic plans and long-range forecasts. The data necessary for the execution of the impairment tests are based on management estimates of future cash flows, which require estimating revenue growth rates and profit margins.

Assets are written down to their fair value when the undiscounted cash flows are less than the carrying value of the assets. The fair value of impaired assets is determined by taking into account these estimated cash flows and using a net present value technique based on discounting these cash flows with the Business-specific Weighted Average Cost of Capital (WACC), which ranged between 7.8% and 14.0% in 2002.
Changes in assumptions and estimates included within the impairment reviews could result in significantly different results than those recorded in the financial statements.

Valuation allowances for certain assets

The Company records its inventories at cost and provides for the risk of obsolescence using the lower of cost or market principle. The expected future use of inventory is based on estimates about future demand and past experience with similar inventories and their usage.
The risk of uncollectibility of accounts receivable is primarily estimated based on prior experience with, and the past due status of, doubtful debtors, while large accounts are assessed individually based on factors that include ability to pay, bankruptcy and payment history. In addition, debtors in certain countries are subject to a higher collectibility risk that is taken into account for assessing the overall risk of uncollectibility.
Should the outcome differ from the assumptions and estimates, revisions to the estimated valuation accounts would be required.

Accounting for income taxes

As part of the process of preparing consolidated financial statements, the Company is required to estimate income taxes in each of the jurisdictions. This process involves estimating actual current tax expense and temporary differences between tax and financial reporting. Temporary differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. The Company must assess the likelihood that deferred tax assets will be recovered from future taxable income. A valuation allowance is recognized to reduce deferred tax assets if, and to the extent that, it is more likely than not that all or some portion of the deferred tax assets will not be realized.
The Company has recorded a valuation allowance of EUR 1,249 million as of December 31, 2002, based on estimates of taxable income by jurisdiction in which the Company operates and the period over which deferred tax assets are recoverable. In the event that actual results differ from these estimates in future periods, and depending on the tax strategies that the Company may be able to implement, changes to the valuation allowance could be required, which could impact our financial position and net income.

Restructuring and other provisions

Contingent liabilities related to restructurings are dependent upon estimates and assessments of whether the criteria for recognition of exit costs have been met, including estimates as to the amount of the potential costs for the employee termination packages and contract terminations. The Company has implemented strict rules for identification and recognition of such restructuring provisions in accordance with US GAAP. These contingent liabilities are recognized by charges against income when the Board of Management has approved a restructuring project and changes are highly unlikely, the employee benefit arrangement has been properly communicated in sufficient detail and the number, functions and locations of employees that will be terminated have been identified.
The Company may consider other restructuring projects that do not yet meet all these conditions and which accordingly are not reflected in the financial statements.

Furthermore, the Company consults with legal counsel on matters related to litigation and other experts both within and outside the Company with respect to matters in the ordinary course of business. A liability is accrued if an adverse outcome is probable and the amount can be reasonably estimated. If either the likelihood of an adverse outcome is only reasonably possible or an estimate is not determinable, the matter is disclosed provided that it is material.

Warranty costs

The Company provides for warranty costs based on historical trends in product return rates and the expected material and labor costs to provide warranty services. If it were to experience an increase in warranty claims compared with historical experience, or costs of servicing warranty claims were greater than the expectations on which the accrual had been based, gross income could be adversely affected.

Accounting for pensions and other postretirement benefits

Retirement benefits represent obligations that will be settled in the future and require assumptions to project benefit obligations and fair values of plan assets. Retirement benefit accounting is intended to reflect the recognition of future benefit costs over the employee's approximate service period, based on the terms of the plans and the investment and funding decisions made by the Company. The accounting requires management to make assumptions regarding variables such as discount rate, rate of compensation increase, return on assets, and future healthcare costs. Management consults with outside actuaries regarding these assumptions at least annually. Changes in these key assumptions can have a significant impact on the projected benefit obligations, funding requirements and periodic cost incurred.

Dutch GAAP

On March 28, 2002, Philips announced the transition to the application of full US GAAP to its financial reporting as from 2002. The change to US GAAP is in line with the Company's commitment to ensuring a fair and suitable basis for comparison against its industry peers. In addition to the US GAAP consolidated financial statements, Dutch GAAP financial statements on a consolidated and single company basis are also provided. A reconciliation of material differences between the two is provided in the separate section entitled 'Dutch GAAP information' on page 110. For purposes of Dutch corporate law, the Company's balance sheet under Dutch GAAP is determinative of the amount available for distribution to shareholders.
The Group financial statements have been prepared on the basis of US GAAP, which differs in certain respects from Dutch GAAP. From January 1, 2002, the most important difference represents goodwill amortization, which is required under Dutch GAAP, whereas under US GAAP goodwill is tested for impairment. Net income determined in accordance with Dutch GAAP amounted to a loss of EUR 3,602 million in 2002, compared with a loss of EUR 2,608 million in 2001. These aggregate amounts result in basic earnings per common share of a loss of EUR 2.83 in 2002 and a loss of EUR 2.04 in 2001. Diluted earnings per common share also amounted to a loss of EUR 2.83 in 2002 and a loss of EUR 2.04 in 2001.

Please refer to the Dutch GAAP section for a description of the primary differences between Dutch GAAP and US GAAP and the Dutch GAAP earnings per common share.

Outlook

Through operational and marketing excellence, we expect that the DAP and Lighting divisions will again outperform their industries in 2003, whilst Consumer Electronics is continuing to improve its overall performance, especially in the USA, 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 Consumer Electronics.

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.

February 7, 2003
Board of Management

Corporate governance

Being a global company and player in the international capital markets, Philips, over the last decades, has continuously improved its corporate governance as one of its most important policy items in line with US, Netherlands and international best practises. The governance of the Company and the Philips Group has been improved substantially, in particular by simplifying, and making more transparent, its corporate structure and by strengthening the accountability of the Board of Management as its executive management and the Supervisory Board as its board of independent supervisory directors, as well as by increasing the rights and powers of its shareholders and communication with investors. In this respect, the consequences for the Company of the US Sarbanes-Oxley Act and the proposed amendments to the listing rules of the New York Stock Exchange were discussed and existing procedures reviewed and, where appropriate in response to these regulations currently effective, changes were effected and formalized. The Company also disclosed its Policy on Auditor Independence, aligned with the new regulations to the extent currently effective. Furthermore, the Company made necessary preparations in view of the CEO and CFO certifications for the 2002 Annual Report on Form 20-F with the US Securities and Exchange Commission. This certification process of the Form 20-F, which incorporates part of this Annual Report, under US law is in addition to the Dutch law provisions according to which each member of the Supervisory Board and the Board of Management has signed the 2002 financial statements for approval.

Audit fees

The aggregate fees billed by KPMG for professional services rendered for the fiscal years 2002 and 2001 were as follows:

in millions of euros	**2002**	2001
Audit fees	**7.0**	6.3
Audit-related fees	**14.8**	15.8
Tax fees	**3.3**	2.3
Other fees	**0.8**	11.9
	25.9	36.3

Audit fees consist of fees for the examination of the consolidated financial statements. Audit-related fees primarily consist of fees for statutory audits (EUR 4.8 million), fees in relation to audits of acquisitions and divestments (EUR 5.4 million) and EDP audits (EUR 1.5 million). Tax fees mainly relate to tax compliance and expatriate tax services. Other fees comprise consultancy fees. Meanwhile KPMG has divested its consultancy business.

Proxy solicitation

Philips attaches great value to its relations with its shareholders. For instance, Philips was one of the key companies in the establishment of the Shareholders' Communication Channel a project of Euronext Amsterdam, banks in the Netherlands and several major Dutch companies to simplify contacts between a participating company and its shareholders.

Philips will use the Shareholders' Communication Channel to distribute the Management Report booklet of its Annual Report and the Agenda for this year's General Meeting of Shareholders as well as an instruction form to enable proxy voting at said Meeting. For the General Meeting of Shareholders on March 27, 2003 a record date (being March 20, 2003) will apply: those persons who on March 20, 2003 hold shares in the Company and are registered as such in one of the registers designated by the Board of Management for the General Meeting of Shareholders will be entitled to participate and vote at the meeting.

Environment

For results of the environmental performance of the Philips Group please refer to the Philips Sustainability Report 2002, which will be available before the Annual General Meeting of Shareholders 2003.

Information technology

Philips is seeking to gain competitive advantage by leveraging the synergy between its businesses. One contribution to this has been the introduction of a comprehensive and consistent IT strategy at corporate level. Consolidation of IT strategies across both product divisions and the corporate functions has made the total portfolio of IT activities across the Philips Group more transparent, led to the identification of cross-organizational opportunities and promoted shared solutions.

In the field of IT, TOP (Transforming into One Philips) has already delivered significant, lasting savings. A number of global task forces have been set up to deliver sustainable structural change to the cost base. In telecommunications this is already being realized through improved vendor/contract management. In IT purchasing, results have been delivered through contract renegotiation.

Philips is adopting a shared services model for corporate core processes. An IT shared services organization has been set up and commenced operations in January 2003. It offers a portfolio of 'best in class' IT services to support the non-business-specific IT requirements of Philips organizations. Service tariffs will be market-competitive and set at a level that contributes to structural cost savings at corporate level.

Philips operates in a highly competitive industry. It recognizes that loss, unauthorized disclosure or unavailability of information or IT systems could impact not only cash flow and profitability, but also legal compliance and Philips' respected company image. In 2002 Philips continued to strengthen its IT security facilities.

Human Resources Management

In 2002 the labor markets slowed down further. In general, Philips held back in its recruitment efforts. On a selective basis, however, recruitment was continued in order to maintain the necessary inflow of talent. The Company continues to hold a strong position on the labor market: the international scope and the exciting and varied business activities provide attractive opportunities for personal growth and career progression.

The worldwide program HR Excellence 2002, which was launched in 2000, was completed in September, resulting in a set of coherent policies, processes and tools for Management Development across the Company. The next program – World Class HR 2004 – was started in 2002. A key element of this effort is the establishment of a company-wide open job market on the Philips Intranet called the Philips Career Center. The Philips Career Center provides employees with easy access to the internal labor market across the Company. Another important improvement to HR in Philips is the top-down roll-out of People Performance Management (PPM). The PPM process strengthens the performance culture in the Company, reinforces the implementation of the company values and supports employee development.

In the context of the company-wide TOP program, a redesign of the HR function was initiated in 2002. Following this redesign, Philips People Services (PPS) will be established to provide HR support to employees and managers based on the concept of shared services and self-service over the Intranet. The objective of this multi-year program is to offer enhanced levels of service on a more cost-effective footing.

Leadership development remains a high priority in HR management in Philips. Across the organization a top-down 360°-degree assessment program combined with intensive coaching has been rolled-out further into the executive population and beyond.

Business Excellence

In 2002 we made further progress in implementing BEST (Business Excellence through Speed and Teamwork). This initiative is aimed at achieving world-class excellence in every aspect of the business. Some 50,000 employees at all levels of the organization are engaged – via cross-functional teams – in process and performance improvements in a wide range of business areas, major objectives being to increase customer satisfaction and operating efficiency, reduce cycle time and improve working conditions and environmental performance. In the course of 2002 the Board of Management stressed the need to embed the Business Balanced Scorecard better in our management processes and to use it as a key tool to focus improvement efforts.Virtually 100% of our operations have been ISO 9000 certified, which provides a solid foundation for our continued journey to excellence. The use of the EFQM excellence model in annual assessments of our global businesses and operations is effectively supplemented by regular surveys of the key processes using dedicated tools.

Auditors' Report

We have audited the consolidated balance sheets of Koninklijke Philips Electronics N.V. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2002, appearing on pages 42 through 109. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Netherlands. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Koninklijke Philips Electronics N.V. and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in accordance with accounting principles generally accepted in the United States of America.

As discussed in the accounting policies section of these consolidated financial statements, during 2002, the Company has given retroactive effect to the change in its comprehensive accounting principles from accounting principles generally accepted in the Netherlands to accounting principles generally accepted in the United States of America.

Eindhoven, February 7, 2003

KPMG Accountants N.V.

Consolidated statements of income of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

Note			2002		2001		2000
	Sales		**31,820**		32,339		37,862
	Cost of sales		**(21,906)**		(23,240)		(25,803)
	Gross margin		**9,914**		9,099		12,059
	Selling expenses	**(5,017)**		(5,027)		(4,960)	
	General and administrative expenses	**(1,404)**		(1,249)		(1,321)	
	Research and development expenses	**(3,043)**		(3,312)		(2,766)	
	Write-off of acquired in-process R&D	**(12)**		(106)		(44)	
	Impairment of goodwill	**(19)**		–		(35)	
	Restructuring and impairment charges	**(484)**		(786)		(152)	
			(9,979)		(10,480)		(9,278)
	Other business income (expense)		**485**		(14)		1,477
2	**Income (loss) from operations**		**420**		(1,395)		4,258
3	Financial income and expenses:						
	- interest	**(384)**		(391)		(167)	
	- impairment charges	**(1,955)**		(526)		–	
	- other	**112**		2		2,160	
			(2,227)		(915)		1,993
	Income (loss) before taxes		**(1,807)**		(2,310)		6,251
4	Income tax (expense) benefit		**(27)**		428		(563)
	Income (loss) after taxes		**(1,834)**		(1,882)		5,688
5	Results relating to unconsolidated companies:						
	- income (loss) excluding impairment charges and amortization of goodwill	**(17)**		(232)		4,080	
	- impairment charges	**(1,305)**		(119)		–	
	- amortization of goodwill	**(24)**		(257)		(124)	
			(1,346)		(608)		3,956
	Group income (loss)		**(3,180)**		(2,490)		9,644
6	Minority interests		**(26)**		15		(67)
	Income (loss) before cumulative effect of change in **accounting principle**		**(3,206)**		(2,475)		9,577
7	Cumulative effect of change in accounting principle		**–**		–		85
8	**Net income (loss)**		**(3,206)**		(2,475)		9,662

The accompanying notes are an integral part of these consolidated financial statements.

Earnings per share

	2002	2001	2000
Weighted average number of common shares outstanding (after deduction of treasury stock) during the year (in thousands)	**1,274,950**	1,278,077	1,312,859
Basic earnings per common share in euros:			
Income (loss) before cumulative effect of change in accounting principle	**(2.51)**	(1.94)	7.30
Net income (loss)	**(2.51)**	(1.94)	7.36
Diluted earnings per common share in euros: *			
Income (loss) before cumulative effect of change in accounting principle	**(2.51)**	(1.94)	7.22
Net income (loss)	**(2.51)**	(1.94)	7.28
Dividend paid per common share in euros (related to prior financial year)	**0.36**	0.36	0.30

* The dilution effects on EPS are only taken into consideration if this does not result in an improvement in income per share or in a reduction in loss per share, as is the case in 2002 and 2001.

The following table shows the comparable effects of adoption of SFAS No. 142 for the three years ended December 31, 2002, 2001 and 2000.

	2002	2001	2000
Reported net income	**(3,206)**	(2,475)	9,662
Add back: Goodwill amortization	**–**	180	138
Intangible amortization	**–**	22	17
Amortization of excess of Company's investment over its underlying equity in unconsolidated companies	**24**	257	124
Adjusted net income	**(3,182)**	(2,016)	9,941
Basic earnings per share:			
As reported	**(2.51)**	(1.94)	7.36
As adjusted	**(2.50)**	(1.58)	7.57
Diluted earnings per share:			
As reported	**(2.51)**	(1.94)	7.28
As adjusted	**(2.50)**	(1.58)	7.49

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated balance sheets of the Philips Group as of December 31

in millions of euros unless otherwise stated

Assets

Note			2002		2001
	Current assets				
	Cash and cash equivalents		1,858		890
9	Receivables:				
	- Accounts receivable – net	4,517		5,298	
	- Accounts receivable from unconsolidated companies	63		122	
	- Other receivables	488		392	
			5,068		5,812
10	Inventories		3,522		4,290
11	Other current assets		603		858
	Total current assets		11,051		11,850
	Non-current assets				
5	Unconsolidated companies:				
	- Investments	5,694		7,090	
	- Loans	395		462	
			6,089		7,552
12	Other non-current financial assets		1,306		3,481
13	Non-current receivables:				
	- Accounts receivable – net	123		149	
	- Accounts receivable from unconsolidated companies	–		1	
	- Other receivables	96		156	
			219		306
14	Other non-current assets		2,553		2,774
15	Property, plant and equipment:				
	- At cost	16,015		18,069	
	- Less accumulated depreciation	(9,878)		(10,351)	
			6,137		7,718
16	Intangible assets excluding goodwill:				
	- At cost	2,529		2,585	
	- Less accumulated amortization	(787)		(621)	
			1,742		1,964
17	Goodwill		3,192		3,557
	Total non-current assets		21,238		27,352
	Total		32,289		39,202

The accompanying notes are an integral part of these consolidated financial statements.

Liabilities and stockholders' equity

Note		2002	2002	2001	2001
	Current liabilities				
	Accounts and notes payable:				
	- Trade creditors	3,138		3,240	
	- Unconsolidated companies	90		3	
			3,228		3,243
18	Accrued liabilities		3,314		3,966
19 20	Short-term provisions		1,276		1,443
21	Other current liabilities		691		813
22 23	Short-term debt		617		1,271
	Total current liabilities		9,126		10,736
	Non-current liabilities				
22 23	Long-term debt		6,492		6,595
19 20	Long-term provisions		1,970		2,297
24	Other non-current liabilities		603		212
	Total non-current liabilities		9,065		9,104
25	Commitments and contingent liabilities		–		–
	Group equity				
6	Minority interests		179		202
26	Stockholders' equity:				
	Priority shares, par value EUR 500 per share:				
	Authorized and issued: 10 shares				
	Preference shares, par value EUR 0.20 per share:				
	Authorized: 3,249,975,000 shares				
	Issued: none				
	Common shares, par value EUR 0.20 per share:				
	Authorized: 3,250,000,000 shares				
	Issued: 1,316,070,392 shares				
	(1,316,070,392 shares in 2001)	263		263	
	Capital in excess of par value	14		13	
	Retained earnings	16,738		20,403	
	Accumulated other comprehensive income (loss)	(1,789)		(225)	
	Treasury shares, at cost: 40,092,469 shares				
	(41,897, 949 shares in 2001)	(1,307)		(1,294)	
			13,919		19,160
	Total		32,289		39,202

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statements of cash flows of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

	2002	2001	2000
Cash flows from operating activities:			
Net income (loss)	**(3,206)**	(2,475)	9,662
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**2,184**	2,671	2,320
Impairment of equity investments	**3,260**	645	–
Net gain on sale of assets	**(643)**	(337)	(6,384)
Loss (income) from unconsolidated companies (net of dividends received)	**54**	501	(1,173)
Minority interests (net of dividends paid)	**26**	(21)	56
Decrease (increase) in working capital	**815**	752	(1,063)
Decrease (increase) in non-current receivables/other assets	**86**	(888)	(510)
(Decrease) increase in provisions	**(336)**	313	396
Other items	**(12)**	87	(308)
Net cash provided by operating activities	**2,228**	1,248	2,996
Cash flows from investing activities:			
Purchase of intangible assets (software)	**(149)**	(234)	(140)
Capital expenditures on property, plant and equipment	**(1,161)**	(2,143)	(3,170)
Proceeds from disposals of property, plant and equipment	**370**	221	178
Cash from derivatives	**422**	–	–
Purchase of other non-current financial assets	**(15)**	(77)	(560)
Proceeds from other non-current financial assets	**98**	550	911
Purchase of businesses – net of cash acquired	**(626)**	(3,636)	(3,209)
Proceeds from sale of interests in businesses	**813**	755	3,586
Net cash used for investing activities	**(248)**	(4,564)	(2,404)
Cash flows before financing activities	**1,980**	(3,316)	592
Cash flows from financing activities:			
(Decrease) increase in short-term debt	**(548)**	(73)	734
Principal payments on long-term debt	**(276)**	(554)	(325)
Proceeds from issuance of long-term debt	**405**	4,580	203
Treasury stock transactions	**(19)**	(336)	(578)
Capital repayment to shareholders	**–**	–	(1,673)
Dividends paid	**(459)**	(458)	(399)
Net cash (used for) provided by financing activities	**(897)**	3,159	(2,038)
Cash provided by (used for) continuing operations	**1,083**	(157)	(1,446)
Effect of changes in exchange rates and consolidations on cash positions	**(115)**	(42)	204
Cash and cash equivalents at beginning of year	**890**	1,089	2,331
Cash and cash equivalents at end of year	**1,858**	890	1,089

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statements of cash flows of the Philips Group (continued)

Supplemental disclosures to consolidated statements of cash flows:

	2002	2001	2000
Decrease (increase) in working capital:			
Decrease (increase) in accounts receivable and prepaid expenses	**97**	1,207	(513)
Decrease (increase) in inventories	**173**	790	(979)
Increase (decrease) in accounts payable and accrued expenses	**545**	(1,245)	429
	815	752	(1,063)
Net cash paid during the year for:			
Interest	**384**	391	167
Income taxes	**313**	355	266
Net gain on sale of assets:			
Cash proceeds from the sale of assets	**1,281**	1,526	4,675
Book value of these assets	**(625)**	(1,190)	(875)
Deferred results sale-and lease-back transactions	**(95)**	(41)	–
Non-cash gain or losses	**82**	42	2,584
	643	337	6,384
Non-cash investing and financing information:			
Assets received in lieu of cash:			
Securities/shares	**113**	–	2,584
Receivables	**–**	63	5
Treasury stock transactions:			
Shares acquired	**(103)**	(379)	(682)
Exercise stock options/warrants/convertible personnel debentures	**84**	43	104

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.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statements of changes in stockholders' equity of the Philips Group

in millions of euros unless otherwise stated

	Outstanding number of shares in thousands	Common stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss): Currency translation differences	Unrealized gain (loss) on available for sale securities	Additional minimum pension liability	Change in fair value of cash flow hedges	Total	Treasury shares at cost	Total stock-holders' equity
Balance as of December 31, 1999	1,331,601	339	1,631	14,073	(962)	2,163	–	(113)	1,088	(423)	16,708
Net income				9,662							9,662
Net current period change					94	982		84	1,160		1,160
Reclassifications into income						(2,173)	(13)		(2,186)		(2,186)
Total comprehensive income (loss), net of tax					94	(1,191)	(13)	84	(1,026)		8,636
Dividend paid				(399)							(399)
Issued upon exercise of:											
- Convertible debentures	458		6								6
Purchase of treasury stock	(15,028)									(682)	(682)
Re-issuance of treasury stock	6,574									111	111
3% share reduction	(39,710)	(76)	(1,630)							33	(1,673)
Balance as of December 31, 2000	1,283,895	263	7	23,336	(868)	972	(13)	(29)	62	(961)	22,707
Net income (loss)				(2,475)							(2,475)
Net current period change					102	(932)	(18)	(18)	(866)		(866)
Reclassifications into income						526	13	40	579		579
Total comprehensive income (loss), net of tax					102	(406)	(5)	22	(287)		(2,762)
Dividend paid				(458)							(458)
Purchase of treasury stock	(12,678)									(379)	(379)
Re-issuance of treasury stock	2,955									46	46
Stock options accrual			6								6
Balance as of December 31, 2001	1,274,172	263	13	20,403	(766)	566	(18)	(7)	(225)	(1,294)	19,160
Net income (loss)				(3,206)							(3,206)
Net current period change					(906)	(2,189)	(335)	(28)	(3,458)		(3,458)
Reclassifications into income					(40)	1,888		46	1,894		1,894
Total comprehensive income (loss), net of tax					(946)	(301)	(335)	18	(1,564)		(4,770)
Dividend paid				(459)							(459)
Purchase of treasury stock	(3,128)									(103)	(103)
Re-issuance of treasury stock	4,934									90	90
Stock options accrual			1								1
Balance as of December 31, 2002	**1,275,978**	**263**	**14**	**16,738**	**(1,712)**	**265**	**(353)**	**11**	**(1,789)**	**(1,307)**	**13,919**

For the tax effect on the changes in stockholders' equity, refer to note 4.

The accompanying notes are an integral part of these consolidated financial statements.

Accounting policies

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ('US GAAP'). The Company adopted application of US GAAP as of January 1, 2002. All previous statements have been restated for this effect, with recognition of the effect in stockholders' equity as of the beginning of the earliest period presented. Historical cost is used as the measurement basis unless otherwise indicated.

Consolidation principles

The consolidated financial statements include the accounts of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics') and all of its subsidiaries in which a direct or indirect controlling interest is maintained. All intercompany balances and transactions have been eliminated in consolidation. Net income is reduced by the portion of the earnings of subsidiaries applicable to minority interests. The minority interests are disclosed separately in the consolidated statements of income and in the consolidated balance sheets.

Investments in companies in which Royal Philips Electronics does not have the ability to directly or indirectly control the financial and operating decisions, but does possess the ability to exert significant influence, are accounted for by the equity method. Generally, significant influence is presumed to exist if at least 20% of the voting stock is owned. The Company's share of the net income of these companies is included in results relating to unconsolidated companies in the consolidated statements of income. The Company recognizes an impairment loss when an other-than-temporary decline in the value of an investment occurs.

Foreign currencies

The financial statements of foreign operations are translated into euros. Assets and liabilities are translated using the exchange rates on the respective balance sheet dates. Income and expense items are translated at weighted average exchange rates during the year. The resulting translation adjustments are recorded as a separate component of other comprehensive income (loss) within stockholders' equity. Cumulative translation adjustments are recognized as income or expense upon disposal or liquidation of a foreign operation.

The functional currency of foreign operations is generally the local currency, unless the primary economic environment requires the use of another currency. However, when foreign operations conduct their business in economies considered to be highly inflationary, they record transactions in a designated functional currency instead of their local currency.
Gains and losses arising from the translation or settlement of foreign currency-denominated monetary assets and liabilities into the local currency are recognized in income in the period in which they arise. However, currency differences on intercompany loans that have the nature of a permanent investment are accounted for as translation differences as a separate component of other comprehensive income (loss) within stockholders' equity.

Derivative financial instruments

The Company uses derivative financial instruments principally in the management of its foreign currency risks and to a more limited extent for interest rate and commodity price risks. Applying Statement of Financial Accounting Standards (SFAS) No. 133, 'Accounting for Derivative Instruments and Hedging Activities', and SFAS No. 138, 'Accounting for Certain Derivative Instruments and Certain Hedging Activities', the Company measures all derivative financial instruments based on fair values derived from market prices of the instruments or from option pricing models, as appropriate. Gains or losses arising from changes in the fair value of the instruments are recognized in the income statement during the period in which they arise to the extent that the derivatives have been designated as a hedge of recognized assets or liabilities, or to the extent that the derivatives have no hedging designation or are ineffective. The gains and losses on the designated derivatives substantially offset the changes in the values of the recognized hedged items, which are also recognized as gains and losses in the income statement.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in the income statement.

Changes in the fair value, resulting from the risk being hedged, of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, are recorded in accumulated other comprehensive income, until earnings are affected by the variability in cash flows of the designated hedged item. Changes in the fair value of derivatives that are highly effective as hedges and that are designated and qualify as foreign currency hedges are recorded in either earnings or accumulated other comprehensive income, depending on whether the hedge transaction is a fair value hedge or a cash flow hedge.

The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair-value hedge, the Company continues to carry the derivative on the balance sheet at its fair value, and no longer adjusts the hedged asset or liability for changes in fair value. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur within a period of two months from the originally forecasted transaction date, the Company continues to carry the derivative on the balance sheet at its fair value, and gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the balance sheet, and recognizes any changes in its fair value in earnings.

For interest rate swaps that are unwound, the gain or loss upon unwinding is released to income over the remaining life of the underlying financial instruments, based on the recalculated effective yield.

Cash and cash equivalents

Cash and cash equivalents include all cash balances and short-term highly liquid investments with an original maturity of three months or less that are readily convertible into known amounts of cash. They are stated at face value.

Investments

The Company classifies its investments in equity securities that have readily determinable fair values as either available-for-sale or for trading purposes and investment in debt securities in one of three categories: trading, available-for-sale or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the short term. Held-to-maturity securities are those debt securities in which the Company has the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts using the effective interest method. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income within stockholders' equity until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis.

A decline in the market value of any available-for-sale security or held-to-maturity security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Dividend and interest income are recognized when earned. Gains or losses, if any, are recorded in financial income and expenses.

For available-for-sale securities hedged under a fair value hedge, the changes in the fair value that are attributable to the risk which is being hedged are recognized in earnings rather than in other comprehensive income.

Investments in privately-held companies are carried at cost, or estimated fair value if an other-than-temporary decline in value exists.

Receivables

Receivables are carried at face value, net of allowances for doubtful accounts.

Inventories

Inventories are stated at the lower of cost or market, less advance payments on work in process. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, taking into account the stage of completion. The cost of inventories is determined using the first-in, first-out (FIFO) method. An allowance is made for the estimated cost of obsolescence.

Other non-current financial assets

Loans receivable are stated at amortized cost, less the related allowance for impaired loans receivable. Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. Impairment losses are included in the allowance for doubtful accounts through a charge to bad debt expense. Cash receipts on impaired loans receivable are applied to reduce the principal amount of such loans until the principal has been recovered and are recognized as interest income thereafter.

Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation. Assets manufactured by the Company include direct manufacturing costs, production overheads and interest charges incurred during the construction period. Government grants are deducted from the cost of the related asset. Depreciation is calculated using the straight-line method over the expected economic life of the asset. Depreciation of special tooling is based either on the straight-line method or on the expected future economic benefit of these tools. Gains and losses on the sale of property, plant and equipment are included in other business income. Costs related to major maintenance activities are expensed in the period in which they are incurred. Plant and equipment under capital leases are stated at the present value of minimum lease payments. These assets and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

Goodwill

The Company adopted the provisions of SFAS No. 141 as of July 1, 2001 and SFAS No. 142 as of January 1, 2002. Consequently, goodwill is no longer amortized but instead tested for impairment annually or whenever impairment indicators require so. Prior to adoption of SFAS No. 142, the Company applied the straight-line method for amortization of goodwill over the period expected to benefit, not exceeding 20 years.

SFAS No. 142 requires the Company to evaluate its existing intangible assets and goodwill that were acquired in purchase business combinations, and to make any necessary reclassifications in order to conform with the new classification criteria in SFAS No. 141 for recognition separate from goodwill. The Company re-assessed the useful lives and residual values of all intangible assets acquired. No amortization period adjustments were necessary.

In connection with SFAS No. 142's transitional goodwill impairment evaluation, the Statement requires the Company to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of January 1, 2002. Furthermore, the Company was required to determine the fair value of each reporting unit and to compare it to the carrying amount of the reporting unit. To the extent the carrying amount of a reporting unit exceeded the fair value of the reporting unit, the Company was required to perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill, both of which would be measured as of the date of adoption. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

The Company identified its reporting units and performed the transitional goodwill impairment test for each of those reporting units in the first quarter of 2002. No impairment arose from these tests.

In addition to the transitional goodwill impairment test the Company performs its annual impairment tests in the second quarter. Fair value of the reporting units was determined using expected discounted future cash flows.

Intangible assets

Intangible assets arising from acquisitions are amortized using the straight-line method over their estimated economic lives, unless the revenues generated by these intangibles have a deviating pattern. In that case, the revenue pattern dictates the amortization scheme. Economic lives are evaluated every year.
In-process Research and Development (R&D) with no alternative use is written off immediately upon acquisition.
Patents and trademarks acquired from third parties are capitalized and amortized over their remaining lives.

Certain costs relating to the development and purchase of software for internal use are capitalized and subsequently amortized over the estimated useful life of the software in conformity with Statement of Position 98-1, 'Accounting for the Costs of Computer Software Developed or Obtained for Internal Use'.

Research and development

All costs of research and development are expensed in the period in which they are incurred, in conformity with SFAS No. 2, 'Accounting for Research and Development Costs'.

Advertising

Advertising costs are expensed when incurred.

Impairment or disposal of intangible assets other than goodwill and tangible fixed assets

The Company accounts for intangible and tangible fixed assets in accordance with the provisions of SFAS No. 144, 'Accounting for the Impairment or Disposal of Long-Lived Assets'. This Statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets held for sale are reported at the lower of the carrying amount or fair value, less costs to sell.

Provisions

The Company recognizes provisions for liabilities and probable losses that have been incurred as of the balance sheet date and for which the amount is uncertain but can be reasonably estimated.

The provision for restructuring relates to the estimated costs of planned reorganizations that have been approved by the Board of Management and publicly announced before the year-end, and which involve the realignment of certain parts of the industrial and commercial organization. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in restructuring provisions.

Provisions for environmental liabilities resulting from past operations or events are recognized when it is probable that a liability has been incurred and the amount can be reasonably estimated. Measurement of liabilities is based on current legal requirements and existing technology. Liabilities and expected insurance recoveries, if any, are recorded separately. The carrying amount of liabilities is regularly reviewed and adjusted for new facts or changes in law or technology.

Provisions are stated at face value, with the exception of certain long-term provisions, such as provisions for postretirement benefits (including pensions) and severance payments in certain countries where such payments are made in lieu of pension benefits; those provisions are stated at the present value of the future obligations.

Debt and other liabilities

Debt and liabilities other than provisions are stated at amortized costs. However, loans that are hedged under a fair value hedge are remeasured for the changes in the fair value that are attributable to the risk that is being hedged.

Revenue recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Generally, these criteria are met at the time the product is shipped or services are rendered and acceptance, when required, has been obtained. For products that require substantive installation activities by the Company, revenue recognition occurs when the criteria for revenue recognition have been met and the product is ready to be used by the customer or has been accepted by the customer. Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. Shipping and handling costs billed to customers are recognized as revenues. Expenses incurred for shipping and handling costs of internal movements of goods are recorded as cost of sales. Those related to sales to third parties are reported as selling expenses and disclosed separately. Service revenue is recognized as services are rendered.
Provision for estimated contract losses, if any, is made in the period that such losses are determined. Royalty income, which is generally payable based upon a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis. Government grants, other than those relating to assets, are recognized as income as qualified expenditures are made.

Income taxes

Income taxes are accounted for under the asset and liability method. Income tax is recognized in the income statement except to the extent that it relates to an item recognized directly within stockholders' equity, including other comprehensive income (loss), in which case the related tax effect is also recognized there. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Measurement of deferred tax assets and liabilities is based upon the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets, including assets arising from loss carryforwards, are recognized if it is more likely than not that the asset will be realized. Deferred tax assets and liabilities are not discounted.

Deferred tax liabilities for withholding taxes are recognized for subsidiaries, in situations where the income is to be paid out as dividends in the foreseeable future, and for undistributed earnings of minority shareholdings.

Changes in tax rates are reflected in the period that includes the enactment date.

Benefit accounting

The Company accounts for the cost of pension plans and postretirement benefits other than pensions in accordance with SFAS No. 87, 'Employers' Accounting for Pensions', and SFAS No. 106, 'Postretirement Benefits other than Pensions', respectively.
Most of the Company's defined-benefit plans are funded with plan assets that have been segregated and restricted in a trust to provide for the pension benefits to which the Company has committed itself.
When plan assets have not been segregated by the Company or in such cases in which the Company is required to make additional pension payments, the Company recognizes a provision for such amounts.

Pension costs, in respect of defined-benefit pension plans, primarily represent the increase in the actuarial present value of the obligation for pension benefits based on employee service during the year and the interest on this obligation in respect of employee service in previous years, net of the expected return on plan assets.

In the event that the accumulated benefit obligation, calculated as the present value of the benefits attributed to employee service rendered and based on current and past compensation levels, exceeds the market value of the plan assets and existing accrued pension liabilities, this difference and the existing prepaid pension asset are recognized as an additional minimum pension liability.

Obligations for contributions to defined-contribution pension plans are recognized as an expense in the income statement as incurred.

In certain countries, the Company also provides postretirement benefits other than pensions. The cost relating to such plans consists primarily of the present value of the benefits attributed on an equal basis to each year of service, interest cost on the accumulated postretirement benefit obligation, which is a discounted amount, and amortization of the unrecognized transition obligation. This transition obligation is being amortized through charges to earnings over a twenty-year period beginning in 1993 in the USA and in 1995 for all other plans.

Unrecognized prior service costs related to pension plans and postretirement benefits other than pensions are being amortized by assigning a proportional amount to the income statements of a number of years reflecting the average remaining service period of the active employees.

Stock-based compensation

The Company accounts for stock-based compensation using the intrinsic value method in accordance with US Accounting Principles Board (APB) Opinion No. 25, 'Accounting for Stock Issued to Employees'. The Company has adopted the pro forma disclosure requirements of SFAS No. 123, 'Accounting for Stock-Based Compensation'. The pro forma net income (loss), basic earnings (loss) per share and diluted earnings (loss) per share, calculated as if the fair value of options granted to option holders would have been considered compensation costs, is (EUR 3,358 million), (2.63) and (2.63) respectively for 2002, (EUR 2,566 million), (2.01) and (2.01) respectively for 2001, and EUR 9,570 million, 7.29 and 7.21 respectively for 2000. Please refer to note 28, Stock-based compensation, for a reconciliation of reported and pro forma income (loss) of earnings per share, as well as the underlying assumptions.

Discontinued operations

The Company has defined its Businesses as components of an entity for the purpose of assessing whether or not operations and cash flows can be clearly distinguished from the rest of the Company, in order to qualify as a discontinued operation in the event of disposal of a Business. Any gain or loss from disposal of a Business, together with the results of these operations until the date of disposal, are reported separately as discontinued operations in accordance with SFAS No. 144. The financial information of a discontinued Business is excluded from the respective captions in the consolidated financial statements and related notes.

Cash flow statements

Cash flow statements have been prepared under the indirect method in accordance with the requirements of SFAS No. 95, 'Statement of Cash flows', as amended by SFAS No. 104. Cash flows in foreign currencies have been translated into euros using the weighted average rates of exchange for the periods involved.
Cash flows from derivative instruments that are accounted for as fair value hedges or cash flow hedges are classified in the same category as the cash flows from the hedged items. Cash flows from derivative instruments for which hedge accounting has been discontinued are classified consistent with the nature of the instrument as from the date of discontinuance.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements in order to conform with generally accepted accounting principles. Actual results could differ from those estimates.

New accounting standards

In June 2001, the FASB issued SFAS No. 143, 'Accounting for Asset Retirement Obligations'. This Statement requires that the fair value of an asset retirement obligation be recognized in the period in which it is incurred and that an equal amount be capitalized as part of the carrying amount of the long-lived asset and subsequently depreciated over the life of the asset. This Standard will become effective for fiscal years beginning after June 15, 2002. Upon adoption, which is required on January 1, 2003, the Company may be required to record a cumulative effect adjustment related to the recognition of such obligations. The Company made a preliminary investigation into the existence of asset retirement obligations. This has revealed that in several cases such obligations do exist. However, the Company has not yet quantified the impact of the recognition of these obligations on its statements of financial position, nor has it determined or estimated what the cumulative effect adjustment in the income statement will be.

In June 2002, the FASB issued SFAS No. 146, 'Accounting for Costs Associated with Exit or Disposal Activities'. This statement nullifies EITF Issue No. 94-3, 'Liability Recognition for Certain Employee Termination Benefit and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)'. The principal difference between Statement 146 and Issue 94-3 that will affect the Company relates to the timing of the recognition of a liability for a cost associated with an exit or disposal activity, including restructurings. Statement 146 requires that a liability be recognized for those costs only when the liability is incurred, i.e. when it meets the definition of a liability. In contrast, under Issue 94-3 the Company recognized a liability for an exit cost or recorded a restructuring provision when it committed to an exit plan. Statement 146 also establishes fair value as the objective for initial measurement of the liability. Liabilities related to employee termination benefits must be recognized rateably over the future service period when those employees are required to render services to the Company, if that period exceeds 60 days or a longer legal notification period. The Statement is effective for exit or disposal activities that are initiated after December 31, 2002 and will be adopted by the Company as of January 1, 2003. Consequently, the accounting for exit or disposal activities initiated before January 1, 2003 will continue under Issue 94-3.

In December 2002, the FASB issued SFAS No. 148 'Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123'. This Statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, it requires more prominent disclosures in both annual and interim financial statements. The Company adopted the disclosure requirements as from 2002.
The Company has decided to adopt the fair value recognition provisions of SFAS No. 123 'Accounting for Stock-Based Compensation' as from January 1, 2003 prospectively to all employee awards granted, modified or settled after January 1, 2003. Under these provisions, the Company will recognize the estimated fair value of equity instruments granted to employees as compensation expense over the vesting period.

Notes to the consolidated financial statements of the Philips Group

all amounts in millions of euros unless otherwise stated

1 Acquisitions and divestments

During 2002 the Company engaged in a number of transactions, of each which was relatively small. However, in the aggregate the cash flows involved represented a net cash inflow of EUR 187 million. A gain of EUR 504 million was recognized on the divestments. Sales and income from operations related to the divested activities amounted to EUR 1,115 million and a loss of EUR 85 million respectively in 2002 and EUR 997 million and a loss of EUR 17 million respectively in 2001.
Below a summary is given of the most important acquisitions and divestments during 2002.

Ishoni Networks

In February, the Company acquired a 51% majority interest in Ishoni Networks, a company based in Santa Clara, California, USA, at a purchase price of EUR 24 million. Ishoni Networks is a silicon and software solution provider for broadband Customer Premise Equipment (CPE) and devices. It employs approximately 160 people. The investment is expected to advance Philips Semiconductors' efforts in Broadband Silicon and Software solutions and to expand a portfolio of silicon system solutions for broadband CPE with advanced networking, voice and security functionality. The investment includes agreements for joint product development, joint sales and marketing activities, and manufacturing. The Company has a call option to acquire the remaining 49% at the current price of EUR 65 million before June 2003.
Based upon an independent appraisal, EUR 10 million was assigned to specific intangible assets acquired. Of this amount, EUR 4 million, representing the value of in-process R&D that has not yet reached technological feasibility and has no alternative use, was charged to expense as of the date of acquisition. Additionally, EUR 9 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. Ishoni has been consolidated in the Semiconductors segment as from February 2002.

Medical glassware business of Richardson Electronics

In February, the Company completed the acquisition of 100% of Richardson Electronics' medical glassware business. Under the terms of the agreement, Philips acquired the net assets and employees of the business, including the reloading and distribution of X-ray, CT and Image Intensifier tubes. The glassware business has operations in Arlington, Texas and Richmond, Virginia and employs approximately 25 people. The investment expands the portfolio of Philips' Dunlee medical tube business, which was acquired in 2001 from Marconi Medical Systems and integrated in the Medical Systems segment. The medical glassware business has been consolidated in this segment as from March 2002.

Fax business

In March, Philips sold its Fax business to Groupe SAGEM of France. The main activities of this business were located in Vienna. Approximately 390 employees were involved within Europe. The reason for this disposal is that strategically the fax market and related printing technologies no longer fit within Philips.

TechnoFusion

In May, the Company completed the sale of TechnoFusion GmbH, a leading maker of power generation systems for automotive electronics, to International Rectifier (IR) for EUR 60 million in cash.
TechnoFusion manufactures high-quality integrated regulator micro-electronic modules for the global automotive industry. With 2001 sales of USD 50 million, TechnoFusion employed approximately 375 people worldwide.

SMATV

The Company and Fracarro Radioindustrie Spa of Italy agreed on the sale of Philips' business unit Satellite Master Antenna Television (SMATV). The deal closed by the end of May. Philips SMATV has been 100% acquired by Fracarro France, a new company of Gruppo Fracarro. All employees, approximately 50, of Philips SMATV have been taken over by Fracarro.

Marantz

Marantz is a leading branded manufacturer of premium home theatre and Audio/Video products in which the Company had a 49% stake. In May, Marantz and DENON, Ltd. merged operations into D&M Holdings, Inc., maintaining the established Marantz and DENON brands. After the merger Philips' share in D&M Holdings, Inc. is 14.7% and accordingly is no longer accounted for under the equity method.

Heat and Surface Treatment

The Company sold its Heat and Surface Treatment (H&ST) activities to Aalberts Industries of the Netherlands in July. H&ST, with sales of EUR 10 million, is located in Acht, the Netherlands, and had around 70 employees.

X-Ray Analytical

In September, the Company sold the major part of its X-ray Analytical Business to Spectrics plc of Egham, United Kingdom, a precision instrumentation and controls company, for EUR 150 million. Philips Analytical's X-ray activities employed approximately 850 people around the world and had sales of EUR 160 million in 2001.

Philips Broadband Networks

In September, C-COR.net of State College, PA, USA, a global provider of broadband communications technology systems and services, acquired Philips Broadband Networks (PBN) for a cash payment of approximately EUR 75 million. Philips Broadband Networks employed approximately 500 people.

Philips Medical Capital

Philips Medical Systems and Rabobank Group's subsidiary De Lage Landen International set up a venture to provide financing for the purchase of the full range of diagnostic imaging equipment produced by Philips Medical Systems throughout the United States. The new venture is called Philips Medical Capital and is based in Wayne, Pennsylvania (United States). De Lage Landen owns a majority stake (60%) in the venture and has operational control. The venture became operative in the 4th quarter of 2002 and is accounted for in accordance with the equity method.

Payer shavers

At the end of October, the Company concluded the sale of Payer Elektroprodukte to Hui Holding Sdn. Bhd. of Malaysia. Payer Elektroprodukte is an Austria-based leading original equipment manufacturer (OEM) of electric foil shavers and was part of Philips' Domestic Appliance and Personal Care (DAP) division. The business had approximately 650 employees, with production facilities in Austria and Hungary.

Communication, Security and Imaging business

In October, the Company and Robert Bosch GmbH concluded the sale of Philips' business unit Communication, Security and Imaging (CSI). Philips CSI is headquartered in Eindhoven, the Netherlands, operating in 35 countries worldwide and employing approximately 1300 people, all of whom have transferred to Bosch. CSI designs, manufactures, sells and supports a broad range of professional communication and security products and systems, including closed-circuit video surveillance (CCTV), congress and public address systems. CSI was profitable with sales of over EUR 300 million in 2001.

Philips Contract Manufacturing Services

In November, the Company and Jabil Circuit Inc., a global leader in Electronic Manufacturing Services (EMS), agreed on the sale of most of Philips Contract Manufacturing Services (PCMS). In connection with this transaction, the Company has agreed to restructure four manufacturing operations. The transaction has resulted in cash inflows in 2002 of EUR 170 million, while in 2003 cash outflows of EUR 87 million will be involved. A loss of EUR 13 million, including a provision to restructure the above-mentioned operations, was recorded on this transaction.

PCMS, with Philips Consumer Electronics as its largest customer, has grown from a specialist in printed circuit board assembly into a full service provider addressing both the internal and external EMS markets as a stand-alone Philips business. This agreement is in line with our strategy to focus on selected activities that fully support the long-term ambitions of the Consumer Electronics division, and the industry trend towards outsourcing.

Under the terms of the agreement, Jabil acquired the manufacturing operations on three continents, including sites in Austria, Belgium, Brazil, China, Hungary, India, Poland and Singapore. From these locations, Jabil will continue to provide key components for the manufacture of a wide range of Philips products, including televisions, DVD and audio systems, storage and display products and set-top boxes under a four-year, four-billion euro product supply agreement.

Jabil will provide design and engineering services, new product introduction, prototype and test services, procurement, PCB assembly, and final assembly and integration. The agreement also covers outsourcing requirements for additional PCMS customers outside Philips.

Health Care Products Group

At the end of November, the sale of the Health Care Products Group to Platinum Equity Holdings was concluded. Final settlement is expected to occur in the first quarter of 2003. The Health Care Products Group (HCP), based in Cleveland, Ohio is active in the distribution and sale of consumable medical film and devices to hospitals and healthcare centers.

HCP, part of Philips Medical Systems, was acquired as part of the Marconi Medical Systems acquisition in 2001. With more than 900 employees and a customer base of over 20,000 healthcare providers in the United States, the company had annual revenues in excess of EUR 600 million.

Systemonic

On December 31, the Company completed the acquisition of Systemonic, a leading developer of complete silicon system solutions. This acquisition adds high-speed wireless connectivity technology to the Philips portfolio. Systemonic has operations in the USA and Germany and employs approximately 90 people. Based on a preliminary valuation, a goodwill amount of EUR 28 million has been recognized. In-process R&D that had no alternative future use amounting to EUR 8 million has been charged to income.

The most significant acquisitions and divestments during 2001 and 2000 were as follows:

Marconi

In October 2001, Philips acquired all the shares of Marconi's Medical Systems business, which comprised two businesses, the core Medical Imaging Equipment business, a global participant in the medical diagnostic imaging equipment industry, and the Marconi Health Care Products Group (HCP), one of the largest distributors of radiology imaging supplies in the USA. Philips divested HCP in 2002. The acquisition price of Marconi Medical Systems was EUR 1.2 billion in cash. The primary reasons for the acquisition were to enhance Medical Systems' computed tomography (CT) portfolio and to acquire an additional CT installed base whose service and maintenance is the most profitable area of the diagnostic imaging industry. The cost of the acquisition has been allocated on the basis of the fair value of the assets acquired and liabilities assumed. The 2001 preliminary allocation was finalized in 2002.

Lighting

In September 2001, Philips acquired the fluorescent lighting ballast operation of Lumisistemas (Mexico) and all lighting ballast activities of Helfont (Brazil). The acquisition price was EUR 72 million. As from the beginning of September 2001, Philips consolidated these newly acquired businesses; EUR 53 million has been recorded as goodwill.

Agilent

In August 2001, Philips completed the acquisition of the net assets of Agilent Technologies Inc.'s Healthcare Solutions Group (HSG) for a total purchase price of EUR 2.0 billion in cash. HSG is active in the field of pervasive cardiology and monitoring solutions, and is a leading global provider of medical products and services to hospitals, healthcare clinics, physicians' offices, airlines and others. The primary reason for the acquisition was to enhance our existing business and to provide Medical Systems with a strong position in the cardiac sector. Additionally, the acquisition enables Medical Systems to enter certain new, high-growth segments such as home care technology enabling remote diagnostics. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. The 2001 preliminary allocation was finalized in 2002.

LG.Philips Displays

In June 2001, Philips and LG Electronics (LGE) completed a definitive agreement through which the two companies merged their respective cathode ray tube (CRT) businesses into a new joint venture company. LGE and Philips share equal control of the joint venture. The joint venture remitted USD 1.1 billion in cash to LGE and USD 0.3 billion to Philips to close the difference in the valuation of the net assets contributed.
The investment is accounted for using the equity method. The excess of the Company's investment over its underlying equity in the recognized net assets has been recorded as goodwill in the caption investments in unconsolidated companies. In accordance with the joint venture agreement between Philips and LGE, Philips paid LGE USD 105 million in 2002, which amount has been included under investments in unconsolidated companies.

Philips Consumer Communications

In October 2001, Philips announced it had signed a definitive agreement with respect to a transfer of Philips' mobile handset activities to China Electronics Corporation (CEC). Under the agreement, Philips contributed part of the research & development and manufacturing activities of Philips Consumer Communications (PCC) into a partnership with CEC. Philips maintained a focused sales and marketing activity in mobile telephony under the Philips brand name.

In December 2001, 65% of the shares in the manufacturing company in China were transferred to the CEC group, bringing their ownership to 75%. Therefore this company was deconsolidated at year-end 2001. The transfer of 100% of the shares in the development company in France was completed in the first quarter of 2002.

Part of the Le Mans manufacturing operations that remained after the restructuring of PCC was sold to European Telecom plc; the transaction was closed on December 31, 2001, therefore the operations were deconsolidated as of December 31, 2001.

FEI

In May 2001, Philips reduced its stake in FEI Company to 26% through a public offering of FEI shares and through the sale of approximately 6 million shares owned by Philips. The cash proceeds were EUR 200 million, resulting in a gain of EUR 185 million included in other business income.
Following the offering, Philips no longer consolidates the financial data of FEI, previously included in the product sector Miscellaneous. The remaining investment is accounted for as an equity investment from May 2001 onwards.

Philips Broadcast

In February 2001, Philips sold its Broadcast group to Thomson Multimedia of France for a cash amount of EUR 165 million, of which EUR 63 million was received in 2002. In relation to this sale a gain was recognized, net of cost of disposal, of EUR 57 million, which is included in other business income.

Other

In May 2001, Philips sold its investment in Philips Matsushita Battery Corporation to its joint venture partner for EUR 42 million, resulting in a gain of EUR 20 million, which is presented under results relating to unconsolidated companies.

In May 2001, Marantz Japan Inc. (MJI) bought the Marantz trademark and the European and American sales organizations from Philips. In addition, Philips sold 1.5% of its shareholding in MJI, reducing its share from 50.5% to 49%. As a result, these activities are no longer consolidated in Philips but are accounted for as an equity investment. Cash proceeds amounted to EUR 40 million, and the gain from this transaction was EUR 3 million.

Early in 2001, Philips became the majority shareholder in NavTech as a result of a conversion of debt into equity. As a consequence, Philips started to consolidate the financial figures of NavTech.

TSMC preferred stock

In November 2000, the Company purchased 1.3 billion redeemable preferred shares in Taiwan Semiconductor Manufacturing Company (a publicly listed Taiwanese company in which the Philips Group has a substantial shareholding) for 13 billion Taiwanese dollars (EUR 458 million). The preferred shares are redeemable in 2003. The dividend yield on these preferred shares is 3.5%. The preferred shares carry the same voting rights as TSMC's common shares. The preferred shares are carried at cost (redemption value) in the accompanying consolidated balance sheet. The redeemable preferred shares result in a concentration of credit risks. However, based on historical results, the Company is of the opinion that TSMC will have sufficient means to redeem the shares at the redemption date in 2003.

ADAC

In December 2000, Philips acquired substantially all of ADAC Laboratories' common stock for USD 18.50 per share for each outstanding share. The total purchase price was EUR 483 million. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and the liabilities assumed. In 2002, goodwill was increased by EUR 6 million, representing the amount originally recognized for the assembled workforce intangible asset, which is no longer allowed to be recognized separately under SFAS No. 141.

MedQuist

During 2000, in a series of transactions, Philips acquired approximately 71% of the outstanding shares in MedQuist, a provider of electronic medical transcription services in the United States, for a total aggregate cash purchase price of EUR 1,339 million. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. In 2002, goodwill was increased by EUR 6 million, representing the amount initially recognized as an intangible asset for an assembled workforce, which is no longer allowed to be recognized separately under SFAS No. 141.

Optiva

In October 2000, Philips acquired all of the outstanding shares of Optiva Corporation, the manufacturer of the Sonicare toothbrush, at a cost of EUR 291 million. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. In 2002, goodwill was increased by EUR 3 million, representing the amount initially recognized as an intangible asset for an assembled workforce, which is no longer allowed to be recognized separately under SFAS No. 141.

MiCRUS

In June 2000, Philips purchased IBM's MiCRUS 8-inch wafer fab in the USA, a semiconductor activity, for which the results of operations have been included in the consolidated financial statements as from June 1, 2000. The acquisition price was EUR 378 million, of which approximately EUR 340 million was paid through December 31, 2001.

Atos Origin

In October 2000, Philips and Atos of France, a leading European IT services provider, merged Atos and Origin, Philips' IT services subsidiary. Under this transaction, Philips received 21.3 million newly issued Atos shares based on Atos' closing price on August 25, 2000 of EUR 122 per share, representing 48.7% of the shares in the combined entity Atos Origin.

Additionally, Philips received two tranches of warrants, each representing approximately 2.4 million Atos Origin shares. These warrants may be exercised in the event the weighted average share price of Atos Origin exceeds EUR 156 per share for twelve consecutive business days within 20 months following the closing date for the first tranche (which has expired), and EUR 208 per share within 32 months for the second tranche. Due to Atos Origin's different reporting cycle, Philips' share in Atos Orgin's earnings can only be accounted for on a three-month delay basis.

AC&M

In May 2000, Philips reached agreement with Yageo Corporation of Taiwan to sell its AC&M (Advanced Ceramics & Modules) business to Yageo Corporation.

The transaction was completed in August 2000, and the Company received cash proceeds of EUR 658 million.

2 Income from operations

For information on sales and income from operations on a geographical and segmental basis, see note 31.

Salaries and wages

	2002	2001	2000
Salaries and wages	6,862	7,292	7,631
Pension costs	130	(411)	(422)
Other social security and similar charges:			
- Required by law	995	1,049	1,009
- Voluntary	196	189	261
Total	**8,183**	8,119	8,479

See note 20 to the financial statements for further information on pension costs.

Employees

The average number of employees during 2002 was 183,395 (2001: 205,870, 2000: 231,161). The number of employees by category is summarized as follows:

	2002			2001	2000
	beginning of year*	end of year	average**	average	average
Production	111,472	97,233	105,897	124,306	124,473
Research & Development	23,218	22,306	22,877	23,661	22,201
Other	39,062	35,175	37,750	39,345	60,484
Permanent employees	173,752	154,714	166,524	187,312	207,158
Temporary employees	14,916	15,373	16,871	18,558	24,003
Total	**188,668**	**170,087**	**183,395**	205,870	231,161

* including changes in consolidation at January 1, 2002

** (de)consolidation changes have not been taken into consideration in determining the average number of employees

The number of employees at year-end 2002 decreased by 18,581 as compared to the beginning of the year.

Remuneration of the Board of Management and Supervisory Board

Please refer to note 29.

Depreciation and amortization

Depreciation of property, plant and equipment and amortization of intangibles are as follows:

	2002	2001	2000
Depreciation of property, plant and equipment	1,814	1,994	1,808
Amortization of software	174	146	86
Amortization of goodwill and other intangibles:			
- Amortization of other intangible assets	165	155	125
- Impairment of goodwill	19	–	35
- Amortization of goodwill relating to consolidated companies acquired before July 1, 2001	–	180	138
Write-off of in-process R&D	12	106	44
	2,184	2,581	2,236

Depreciation of property, plant and equipment and amortization of software are primarily included in cost of sales.

Included in the table above is an amount of EUR 233 million (2001: EUR 240 million, 2000: EUR 47 million) that is reported under restructuring and impairment charges.

Depreciation of property, plant and equipment includes an additional write-off in connection with the retirement of property, plant and equipment amounting to EUR 32 million in 2002 (2001: EUR 25 million, 2000: EUR 19 million).

Amortization of other intangible assets increased since it includes a full-year of amortization with respect to acquisitions occurring in the second half of 2001, mainly the medical systems businesses of Marconi and Agilent. Goodwill is no longer amortized but is tested for impairment as Philips applies SFAS No. 142 as from January 1, 2002.

Rent

Rent expenses amounted to EUR 451 million in 2002 (2001: EUR 388 million).

Selling expenses

Advertising and sales promotion costs incurred during 2002 totaled EUR 952 million (2001: EUR 988 million, 2000: EUR 1,039 million) and are included in selling expenses. Moreover, shipping and handling costs of EUR 605 million are also included (2001: EUR 582 million).

General and administrative expenses

General and administrative expenses include the costs related to management and staff departments in the corporate center, product divisions and country/regional organizations, amounting to EUR 1,406 million in 2002 (2001: EUR 1,539 million, 2000: EUR 1,714 million). Additionally, the pension costs and costs of other postretirement benefit plans not attributable to product divisions amounted to a net benefit of EUR 2 million in 2002 (2001: benefit of EUR 290 million, 2000: benefit of EUR 393 million). Lower pension costs in the Netherlands and higher pension costs, predominantly in the United States and the United Kingdom, resulted in a lower benefit in 2002 compared to 2001.

Research and development expenses

Expenditures for research and development activities amounted to EUR 3,043 million, representing 9.6% of Group sales (2001: EUR 3,312 million, 10.2% of sales, 2000: EUR 2,766 million, 7.3% of Group sales).

Write-off of acquired in-process Research and Development

The write-off of acquired in-process R&D in 2002 related to the acquisition of Semiconductors' businesses Ishoni and Systemonic (EUR 12 million); in 2001 it related to the acquisitions of the medical systems businesses of Agilent and Marconi (EUR 106 million); in 2000 it related to the acquisition of ADAC (EUR 44 million).

Restructuring and impairment charges

The following table presents the changes in the restructuring provision from December 31, 1999 to December 31, 2002:

	balance December 31, 2001	additions	utilized	releases	other changes	balance December 31, 2002
Personnel costs	326	245	(235)	(61)	(18)	257
Write-down of assets	6	214	(194)	(7)	(4)	15
Other costs	110	103	(44)	(10)	(4)	155
Total	**442**	**562**	**(473)**	**(78)**	**(26)***	**427**

* other changes primarily related to translation differences

	balance December 31, 2000	additions	utilized	releases	other changes	balance December 31, 2001
Personnel costs	67	437	(166)	(12)		326
Write-down of assets	22	240	(253)	(3)		6
Other costs	11	136	(66)	(12)	41	110
Total	100	813	(485)	(27)	41*	442

* relates to transferred provisions to the joint venture LG.Philips Displays and restructuring recorded in conjunction with the acquisition of Marconi

	balance December 31, 1999	additions	utilized	releases	other changes	balance December 31, 2000
Personnel costs	84	125	(115)	(27)		67
Write-down of assets	13	47	(28)	(10)		22
Other costs	18	26	(24)	(9)		11
Total	115	198	(167)	(46)	–	100

In 2002, asset write-downs are mainly related to Consumer Electronics, Components, Semiconductors and Medical Systems, while in 2001 they were primarily related to Digital Networks and Consumer Communications (as part of Consumer Electronics), Components and Semiconductors. In 2000, asset write-downs were recorded primarily in the Components and Miscellaneous sectors.

Inventory write-downs as part of restructuring projects are recorded in the cost of sales and amount to EUR 10 million (2001: EUR 307 million; 2000: EUR 10 million), which are not included in the tables above.
The movements in the provision for restructuring costs in 2002 are presented by sector as follows:

	balance December 31, 2001	additions	utilized	releases	other changes	balance December 31, 2002
Lighting	16	20	(11)	(7)	(2)	16
Consumer Electronics	137	116	(124)	(16)	(1)	112
DAP	1	9	(4)			6
Components	61	180	(104)	(19)	(5)	113
Semiconductors	41	178	(126)	(11)	(6)	76
Medical Systems	116	28	(93)	(4)	(6)	41
Miscellaneous	67	31	(11)	(21)	(6)	60
Total	**442**	**562**	**(473)**	**(78)**	**(26)**	**427**

Additions of EUR 562 million are presented by sector as follows:

	personnel costs	write-down of fixed assets	other costs	total
Lighting	20			20
Consumer Electronics	83	27	6	116
DAP	7	2		9
Components	78	43	59	180
Semiconductors	38	112	28	178
Medical Systems		28		28
Miscellaneous	19	2	10	31
Total	245	214	103	562

The movements in the provision for restructuring costs in 2001 are presented by sector as follows:

	balance December 31, 2000	additions	utilized	releases	other changes	balance December 31, 2001
Lighting	25	24	(25)	(8)		16
Consumer Electronics	5	271	(138)	(1)		137
DAP	6	4	(9)			1
Components	51	132	(105)	(11)	(6)	61
Semiconductors		167	(126)			41
Medical Systems		79	(6)	(4)	47	116
Miscellaneous	8	99	(37)	(3)		67
Unallocated	5	37	(39)			3
Total	100	813	(485)	(27)	41*	442

* relates to transferred provisions to the joint venture LG.Philips Displays and restructuring recorded in conjunction with the acquisition of Marconi

Additions of EUR 813 million are presented by sector as follows:

	personnel costs	write-down of fixed assets	other costs	total
Lighting	20		4	24
Consumer Electronics	147	74	50	271
DAP	2		2	4
Components	51	53	28	132
Semiconductors	53	91	23	167
Medical Systems	70		9	79
Miscellaneous	71	8	20	99
Unallocated	23	14		37
Total	437	240	136	813

The movements in the provision for restructuring costs in 2000 are presented by sector as follows:

	balance December 31, 1999	additions	utilized	releases	other changes	balance December 31, 2000
Lighting	43	31	(35)	(14)		25
Consumer Electronics	21	27	(33)	(10)		5
DAP		12	(6)			6
Components	3	82	(22)	(12)		51
Semiconductors	6		(4)	(2)		
Miscellaneous	20	38	(42)	(8)		8
Unallocated	22	8	(25)			5
Total	115	198	(167)	(46)	–	100

Additions of EUR 198 million are presented by sector as follows:

	personnel costs	write-down of fixed assets	other costs	total
Lighting	27		4	31
Consumer Electronics	18	3	6	27
DAP	7	1	4	12
Components	53	17	12	82
Miscellaneous	17	21		38
Unallocated	3	5		8
Total	125	47	26	198

The projects initiated in 2002 will ultimately reduce direct labor by approximately 3,900 persons and indirect labor by approximately 2,800 persons.

As in 2001, the release of surplus in 2002 was primarily attributable to reduced severance due to a transfer of employees, who were scheduled to be laid off, to other positions in the Company. The release in 2000 related to a change in severance as well as lower expenditures than originally planned.

The remaining prior-year provisions available at December 31, 2002 relate primarily to personnel costs. The Company expects to make cash expenditures of EUR 412 million in 2003 under existing restructuring programs.

Other business income (expense)

Other business income in 2002 consists of results on disposal of fixed assets, results on disposal of businesses and acquisition-related costs. An amount of EUR 504 million relates to the net gain from the disposal of certain business interests (2001: EUR 287 million, 2000: EUR 1,429 million). In 2002, income primarily related to the sale of PCMS, CSI, PBN and Analytical amounting to EUR 83 million, EUR 71 million, EUR 49 million and EUR 85 million respectively. Furthermore, the earn-out of JDS Uniphase shares, related to the sale of Philips Optoelectronics in 1998, resulted in a gain of EUR 113 million. Various other disposals of businesses resulted in a gain of EUR 103 million. In 2001, EUR 185 million arose from the sale of a portion of Philips' share in FEI Company. In 2000, the gain primarily related to the Atos Origin merger (EUR 1,072 million) and the sale of AC&M (EUR 309 million).

Other business income also includes gains of EUR 65 million from the sale of fixed assets (2001: EUR 30 million, 2000: EUR 48 million) and acquisition-related costs of EUR 84 million primarily related to the integration of the Medical Systems acquisitions in 2001 (EUR 331 million).

3 Financial income and expenses

	2002	2001	2000
Interest income	36	66	99
Interest expense	(420)	(457)	(266)
Total interest expense, net	(384)	(391)	(167)
Impairment loss on available for sale securities	(1,955)	(526)	–
Income from non-current financial assets	107	67	2,230
Foreign exchange results	16	(64)	(81)
Miscellaneous financing costs	(11)	(1)	11
Total other income and expense	112	2	2,160
Total	(2,227)	(915)	1,993

Impairment losses in 2002 resulted from the other-than-temporary decline in the value of Vivendi Universal (EUR 1,855 million), GN Great Nordic (EUR 27 million) and JDS Uniphase shares (EUR 73 million) and totaled EUR 1,955 million (see note 12). In 2001, Vivendi Universal and GN Great Nordic shares were impaired for an amount of EUR 440 million and EUR 86 million respectively.

Income from non-current financial assets in 2002 includes a portion of ASML shares which were sold, resulting in a gain of EUR 67 million. In 2001, no securities were sold. The year 2000 includes the gain on the sale of JDS Uniphase shares of EUR 1,207 million. Additionally, 2000 includes the gain on the exchange of Seagram shares for Vivendi Universal shares, amounting to EUR 1,115 million, net of a US dollar hedge result and taxes.

Dividends received in 2002 on shares of Vivendi Universal of EUR 33 million (2001: EUR 33 million) are classified under income from non-current financial assets. In 2000, dividends received from Seagram of EUR 32 million were classified under income from non-current financial assets.

Miscellaneous financing costs in 2002 mainly reflect the commitment fees (EUR 10 million) for the USD 3.5 billion revolving credit facility, which was closed during the year.

4 Income taxes

The tax expense on income before tax amounted to EUR 27 million in 2002 (2001: tax benefit EUR 428 million, 2000: tax expense EUR 563 million).

The components of income before taxes are as follows:

	2002	2001	2000
Netherlands	(1,434)	(646)	4,620
Foreign	(373)	(1,664)	1,631
Income (loss) before taxes	(1,807)	(2,310)	6,251
The components of income tax expense are as follows:			
Netherlands:			
Current taxes	14	63	(120)
Deferred taxes	48	130	(277)
	62	193	(397)
Foreign:			
Current taxes	(244)	(288)	(342)
Deferred taxes	155	523	176
	(89)	235	(166)
Income tax (expense) benefit	(27)	428	(563)

Philips' operations are subject to income taxes in various foreign jurisdictions with statutory income tax rates varying from 16% to 42%, which causes a difference between the weighted average statutory income tax rate and the Netherlands' statutory income tax rate of 34.5%.
A reconciliation of the weighted average statutory income tax rate as a percentage of income before taxes and the effective income tax rate is as follows:

	2002	2001	2000
Weighted average statutory income tax rate	**34.1**	31.7	34.2
Tax effect of:			
Utilization of previously unrecognized loss carryforwards	**3.1**	3.9	(2.5)
New loss carryforwards not recognized	**(8.0)**	(4.8)	1.4
Changes in the valuation allowance	**(3.2)**	(1.2)	(2.9)
Non-tax deductible impairment charges	**(37.3)**	(8.0)	–
Non-taxable income	**14.1**	7.4	(22.3)
Non-tax deductible expenses	**(2.8)**	(7.0)	3.0
Withholding and other taxes	**(1.2)**	(2.9)	1.3
Tax incentives and other	**(0.3)**	(0.6)	(3.2)
Effective tax rate	**(1.5)**	18.5	9.0

The tax effects of transactions recorded as other comprehensive income (loss) within stockholders' equity are recognized on a net-of-tax basis. The amounts recorded in 2002 include a tax benefit of EUR 179 million related to the minimum pension liability. Additionally, a tax charge relating to the deferred results on hedge transactions of EUR 9 million was recorded (2001: EUR 16 million; 2000: EUR 85 million). Other items affecting other comprehensive income do not have tax consequences.

Deferred tax assets and liabilities

Deferred tax assets and deferred tax liabilities are as follows:

	2002		2001	
	assets	liabilities	assets	liabilities
Intangible assets	**140**	**(250)**	70	(480)
Property, plant and equipment	**90**	**(130)**	240	(150)
Inventories	**150**	**(30)**	220	(40)
Receivables	**250**	**(10)**	70	(10)
Provisions:				
- Pensions	**100**	**–**	100	(140)
- Restructuring	**140**	**–**	150	–
- Guarantees	**40**	**–**	10	–
- Other	**620**	**(10)**	600	(10)
Other assets	**190**	**(410)**	220	(430)
Other liabilities	**190**	**(132)**	220	(313)
Total deferred tax assets/liabilities	**1,910**	**(972)**	1,900	(1,573)
Net deferred tax position	**938**		327	
Tax loss carryforwards (including tax credit carryforwards)	**1,725**		1,927	
Valuation allowances	**(1,249)**		(1,258)	
Net deferred tax assets	**1,414**		996	

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income in the countries where the net operating losses were incurred. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowance at December 31, 2002.
The valuation allowance for deferred tax assets as of December 31, 2002 and 2001 was EUR 1,249 million and EUR 1,258 million respectively. The net change in the total valuation allowance for the years ended December 31, 2002 and 2001 was a decrease of EUR 9 million and an increase of EUR 293 million respectively.

The portion of the valuation allowance relating to deferred tax assets, for which subsequently recognized tax benefits will be allocated to reduce goodwill or other non-current intangible assets of an acquired entity or directly to contributed capital, amounts to EUR 53 million (2001: EUR 52 million).

At December 31, 2002, operating loss carryforwards expire as follows:

Total	2003	2004	2005	2006	2007	2008/2012	later	unlimited
4,520	140	120	40	40	240	170	480	3,290

The Company also has tax credit carryforwards of EUR 302 million, which are available to offset future tax, if any, and which expire as follows:

Total	2003	2004	2005	2006	2007	2008/2012	later	unlimited
302	9	3	2	14	7	10	22	235

Classification of the deferred tax assets and liabilities takes place at a fiscal entity level as follows:

	2002	2001
Deferred tax assets grouped under other non-current assets	**1,152**	980
Deferred tax assets grouped under other current assets	**346**	516
Deferred tax liabilities grouped under provisions	**(84)**	(500)
	1,414	996

Classification of the income tax payable and receivable is as follows:

	2002	2001
Income tax receivable grouped under non-current receivables	**67**	101
Income tax receivable grouped under current receivables	**136**	42
Income tax payable grouped under current liabilities	**(268)**	(206)
Income tax payable grouped under non-current liabilities	**(114)**	(122)

The amount of the unrecognized deferred income tax liability for temporary differences, EUR 167 million (2001: EUR 145 million), relates to unremitted earnings in foreign Group companies, which are considered to be permanently re-invested. Under current Dutch tax law, no additional taxes are payable. However, in certain jurisdictions, withholding taxes would be payable.

5 Unconsolidated companies

Results relating to unconsolidated companies

	2002	2001	2000
Results relating to unconsolidated companies:			
- income (loss) excluding impairment charges and amortization of goodwill	(17)	(232)	4,080
- impairment charges	(1,305)	(119)	–
- amortization of goodwill	(24)	(257)	(124)
Total	(1,346)	(608)	3,956

The results relating to unconsolidated companies for 2002 are affected by a number of special items. The results include the Company's share (EUR 301 million) of restructuring and impairment charges recorded by LG.Philips Displays, in connection with a structural reduction of fixed costs. Additionally, the Company recognized impairment charges of EUR 1,305 million. These related to the investment in LG.Philips Displays (EUR 275 million), a write-down of the investment in Atos Origin (EUR 921 million) to its lower market value, and write-downs of several smaller investments (EUR 109 million). Philips' share in net income of LG.Philips LCD resulted in a profit of EUR 169 million. Various other unconsolidated companies (primarily TSMC, LG.Philips Displays, SSMC and Atos Origin) contributed on balance a profit of EUR 103 million. The dilution effect of Philips' shareholding in TSMC amounted to a loss of EUR 12 million, reducing Philips' shareholding by 0.12%.

In 2001, Philips sold its ownership in Philips Matsushita Battery Corporation, resulting in a gain of EUR 20 million. The results of LG.Philips Displays include a restructuring charge of EUR 89 million. The employee stock option program of TSMC had a dilution effect on Philips' shareholding in the company, amounting to a loss of EUR 60 million. Additionally, results of TSMC included a special charge of EUR 82 million for impairment at a TSMC subsidiary, partly offset by a gain of EUR 41 million related to a reduction in the provision for withholding tax.

The results for 2000 included several special items. A gain of EUR 680 million was recorded in conjunction with issuance of shares by TSMC at a price in excess of the Company's per share carrying value. Additionally, the sale of ASM Lithography shares in June 2000 resulted in a gain of EUR 2,595 million. Furthermore, the exchange of Philips' approximately 33% equity interest in Beltone Electronics Inc. for shares of GN Great Nordic A/S resulted in a gain of EUR 122 million.

Results relating to unconsolidated companies included the amortization of the excess of the Company's investment over its underlying equity in the net assets of unconsolidated companies (2001: EUR 90 million, 2000: EUR 84 million) and the Company's share of amortization recorded by the unconsolidated companies (2001: EUR 167 million, 2000: EUR 40 million). As from January 1, 2002 (from June 30, 2001 for goodwill on business combinations after that date), goodwill recorded by the unconsolidated companies is no longer amortized but instead tested for impairment at least annually. Also, the amortization of the excess of the Company's investment over its underlying equity in the net assets of unconsolidated companies ceased as from January 1, 2002. Instead the Company has tested its investments for impairment whenever there are indications of impairment, which resulted in the above mentioned impairment charges in 2002.

Included in amortization of goodwill in 2002 is EUR 24 million relating to the fourth quarter of 2001 of Atos Origin, as their results are reported on a three-month delay basis. Income from unconsolidated companies accounted for under the cost method includes EUR 2 million (2001: EUR 1 million) representing dividends received.

Investments in, and loans to, unconsolidated companies

The changes during 2002 are as follows:

	total	investments	loans
Balance as of January 1, 2002	7,552	7,090	462
Changes:			
Acquisitions/additions	272	256	16
Sales/redemptions	(68)	(48)	(20)
Goodwill	162	162	–
Impairments	(1,305)	(1,305)	–
Share in income	(34)	(34)	–
Dividend received	(7)	(7)	–
Changes in consolidations	(1)	(1)	–
Translation and exchange rate differences	(482)	(419)	(63)
Balance as of December 31, 2002	**6,089**	**5,694**	**395**

Included in investments is EUR 1,761 million (2001: EUR 1,874 million) of goodwill representing the excess of the Company's investment over its underlying equity in the net assets of the unconsolidated companies.

Loans to unconsolidated companies include redeemable preferred shares of TSMC for an amount of EUR 374 million (2001: EUR 431 million), which will be redeemed in 2003. The investments in unconsolidated companies at December 31, 2002 include EUR 121 million (2001: EUR 204 million) for companies accounted for under the cost method.

The total carrying value of investments in, and loans to, unconsolidated companies is summarized as follows:

	2002		2001
	shareholding %	amount	
Philips' joint ventures with LGE (Korea)	50	**2,918**	3,062
Taiwan Semiconductor Manufacturing Co. (Taiwan)	21.7	**2,228**	2,476
Atos Origin (France)	48.4	**495**	1,388
Other		**448**	626
Total		**6,089**	7,552

The fair values of Philips' shareholdings in TSMC and Atos Origin, based on quoted market prices at December 31, 2002, were EUR 4,738 million and EUR 495 million respectively.

Summarized financial information for the Company's equity investments in unconsolidated companies on a combined basis is presented below:

	January-December		
	2002	2001	2000
Net sales	**16,742**	12,697	9,039
Income before taxes	**667**	(911)	2,572
Income taxes	**(274)**	38	(4)
Income after taxes	**393**	(873)	2,568
Net income	**140**	(1,091)	2,594
Total share in net income of unconsolidated companies recognized in the consolidated statements of income	**(36)**	(482)	648

	December 31,	
	2002	2001
Current assets	**7,714**	7,740
Non-current assets	**18,546**	18,882
	26,260	26,622
Current liabilities	**(5,671)**	(6,397)
Non-current liabilities	**(5,406)**	(4,924)
Net asset value	**15,183**	15,301
Investment in and loans to unconsolidated companies, excl. goodwill	**4,328**	5,678
Goodwill related to unconsolidated companies	**1,761**	1,874
Investments in and loans to unconsolidated companies included in the consolidated balance sheet	**6,089**	7,552

6 Minority interests

The share of minority interests in the income of Group companies in 2002 amounted to EUR 26 million, compared with their share in the loss in 2001 of EUR 15 million and their share in income of EUR 67 million in 2000.

Minority interests in consolidated companies, totaling EUR 179 million (2001: EUR 202 million), are based on the third-party shareholding in the underlying net assets. The change in 2002 is mainly attributable to translation differences.

7 Cumulative effect of change in accounting principle

In 2000, the Company adopted SFAS No. 133. The cumulative effect of this change in accounting principle for derivative instruments resulted in a gain of EUR 85 million, representing the changes in the value of foreign exchange contracts relating to hedges of securities.

8 Earnings per share

The earnings per share data have been calculated in accordance with SFAS No. 128, 'Earnings per Share', as per the following schedule:

		2002		2001		2000
Weighted average number of shares		**1,274,950,373**		1,278,076,537		1,312,859,102
Basic EPS computation						
Income (loss) before cumulative effect of change in accounting principle available to holders of common shares		**(3,206)**		(2,475)		9,577
Cumulative effect of change in accounting principles		**–**		–		85
Net income (loss) available to holders of common shares		**(3,206)**		(2,475)		9,662
Diluted EPS computation						
Income (loss) before cumulative effect of change in accounting principle available to holders of common shares		**(3,206)**		(2,475)		9,577
Plus interest on assumed conversion of convertible debentures, net of taxes		**–**		1		1
Income available to holders of common shares		**(3,206)**		(2,474)		9,578
Cumulative effect of change in accounting principle		**–**		–		85
Net income (loss) available to holders of common shares plus effect of assumed conversions		**(3,206)**		(2,474)		9,663
Weighted average number of shares		**1,274,950,373**		1,278,076,537		1,312,859,102
Plus shares applicable to:						
Options	**2,628,259**		6,420,978		9,961,410	
Convertible debentures	**1,423,643**		2,046,122		3,717,651	
Dilutive potential common shares		**4,051,902**		8,467,100		13,679,061
Adjusted weighted average number of shares		**1,279,002,275**		1,286,543,637		1,326,538,163
Earnings per share:						
- Basic earnings		**(2.51)**		(1.94)		7.36
- Diluted earnings *		**(2.51)**		(1.94)		7.28

* The dilution effects on EPS are only taken into consideration if this does not result in an improvement in income per share or in a reduction in loss per share, as is the case in 2002 and 2001.

9 Receivables

Trade accounts receivable include instalment accounts receivable of EUR 60 million (2001: EUR 69 million).

Income taxes receivable (current portion) totaling EUR 136 million (2001: EUR 42 million) are included under other receivables.

The changes in the allowance for doubtful accounts are as follows:

	2002	2001	2000
Balance as of January 1,	**281**	181	278
Additions charged to income	**72**	43	59
Deductions from allowance *	**(89)**	(37)	(182)
Other movements **	**(39)**	94	26
Balance as of December 31,	**225**	281	181

* Write-offs for which an allowance was previously provided
** Including the effect of translation differences and consolidation changes

10 Inventories

Inventories are summarized as follows:

	2002	2001
Raw materials and supplies	1,164	1,507
Work in process	565	762
Finished goods	1,881	2,187
Advance payments on work in process	(88)	(166)
Total	3,522	4,290

The amounts recorded above are net of the reserve for obsolescence. The changes in the reserve for obsolescence of inventories are as follows:

	2002	2001	2000
Balance as of January 1,	909	754	630
Additions charged to income	229	397	302
Deductions from reserve	(363)	(351)	(243)
Other movements *	(74)	109	65
Balance as of December 31,	701	909	754

* Including the effect of translation differences and consolidation changes

11 Other current assets

Other current assets primarily consist of a current deferred tax asset of EUR 346 million (2001: EUR 516 million) and prepaid expenses.

12 Other non-current financial assets

The changes during 2002 are as follows:

	total	security investments	loans	restricted liquid assets
Balance as of January 1, 2002	3,481	3,088	95	298
Changes:				
Acquisitions/additions	226	113	21	92
Sales/redemptions	(127)	(5)	(12)	(110)
Value adjustments	(2,257)	(2,254)	(1)	(2)
Translation and exchange differences	(17)	–	(11)	(6)
Balance as of December 31, 2002	1,306	942	92	272

Security investments at December 31 consisted of the following available-for-sale securities:

	2002	2001
Total cost	**680**	2,527
Net unrealized gains	**262**	561
Net unrealized losses	**–**	–
Total fair value	**942**	3,088

Included in security investments are shares in Vivendi Universal (38,265,561 in 2002 and 2001), ASML (2002: 27,250,000, 2001: 30,000,000), JDS Uniphase (2002: 49,715,996, 2001: 10,477,168) and GN Great Nordic (6,830,687 in 2002 and 2001).

During 2002, the number of JDS Uniphase shares increased by 39,238,828 million as a result of the earn-out arising from the sale of Philips Optoelectronics in 1998. A net gain of EUR 113 million was recorded under other business income, which is in accordance with the original classification of the gain on the divestment of Philips Optoelectronics. Additionally, the Company sold 2,750,000 shares in ASML at a gain of EUR 67 million (refer to note 3), which has been recorded under financial income and expenses.

During the year, the Company recognized impairment losses totaling EUR 1,955 million in financial income and expenses related to investments in Vivendi Universal (EUR 1,855 million), JDS Uniphase (EUR 73 million) and GN Great Nordic (EUR 27 million).

13 Non-current receivables

Non-current receivables include receivables with a remaining term of more than one year, and the non-current portion of income taxes receivable amounting to EUR 67 million (2001: EUR 101 million).

14 Other non-current assets

Other non-current assets in 2002 are primarily comprised of prepaid pension costs of EUR 1,384 million (2001: EUR 1,740 million) and deferred tax assets of EUR 1,152 million (2001: EUR 980 million).

15 Property, plant and equipment

The components of property, plant and equipment and the changes during 2002 were as follows:

Property, plant and equipment	total	land and buildings	machinery and installations	lease assets	other equipment	prepayments and construction in progress	no longer productively employed
Balance as of January 1, 2002:							
Cost	18,069	3,732	10,297	159	2,796	1,048	37
Accumulated depreciation	(10,351)	(1,708)	(6,486)	(109)	(2,016)	–	(32)
Book value	7,718	2,024	3,811	50	780	1,048	5
Changes in book value:							
Capital expenditures	1,161	152	721	27	295	(40)	6
Retirements and sales	(213)	(58)	(121)	(2)	(13)	(18)	(1)
Depreciation	(1,753)	(153)	(1,203)	(23)	(373)	–	(1)
Write-downs and impairments	(29)	(2)	(20)	(6)	(1)	–	–
Translation differences	(645)	(187)	(313)	(6)	(68)	(68)	(3)
Changes in consolidation	(102)	(16)	(43)	–	(41)	(2)	–
Total changes	(1,581)	(264)	(979)	(10)	(201)	(128)	1
Balance as of December 31, 2002:							
Cost	16,015	3,328	9,237	155	2,343	920	32
Accumulated depreciation	(9,878)	(1,568)	(6,405)	(115)	(1,764)	–	(26)
Book value	**6,137**	**1,760**	**2,832**	**40**	**579**	**920**	**6**

Land (with a book value of EUR 194 million) is not depreciated.

The expected service lives as of December 31, 2002 were as follows:

Buildings	from 14 to 50 years
Machinery and installations	from 5 to 10 years
Lease assets	from 3 to 5 years
Other equipment	from 3 to 5 years

Property, plant and equipment includes EUR 8 million (2001: EUR 15 million) for capital leases and other beneficial rights of use, such as building rights and hire purchase agreements. The financial obligations arising from these contractual agreements are reflected in long-term debt. Capital expenditures includes capitalized interest related to the construction in progress amounting to EUR 8 million.

16 Intangible assets excluding goodwill

The changes during 2002 were as follows:

	total	other intangible assets	software
Balance as of January 1, 2002:			
Acquisition cost	2,585	1,909	676
Accumulated amortization	(621)	(359)	(262)
Book value	1,964	1,550	414
Changes in book value:			
Reclassifications	(32)	(32)	–
Acquisitions/additions	403	254	149
Amortization	(351)	(177)	(174)
Impairments	–	–	–
Translation differences	(239)	(208)	(31)
Changes in consolidation	(3)	(1)	(2)
Total changes	(222)	(164)	(58)
Balance as of December 31, 2002:			
Acquisition cost	2,529	1,813	716
Accumulated amortization	(787)	(427)	(360)
Book value	**1,742**	**1,386**	**356**

At December 31, 2002, other intangible assets included EUR 181 million which was recorded in conjunction with the recognition of a minimum pension liability. Also included are other intangible assets consisting of:

	gross	accumulated amortization	net
Marketing-related	63	(50)	13
Customer-related	546	(72)	474
Contract-based	14	(3)	11
Technology-based	848	(261)	587
Patents and trademarks	161	(41)	120
Total	1,632	(427)	1,205

The estimated amortization expense for these other intangible assets for each of the five succeeding years are:

2003	131
2004	130
2005	129
2006	98
2007	86

The final appraisal value of other intangible assets related to certain acquisitions in 2001, resulted in an adjustment to the amount originally assigned on a provisional basis. The reallocation of the purchase price to other intangibles is reflected under 'reclassifications' (see note 17).

Additionally, amounts previously recognized as intangible assets with respect to acquired assembled workforces, which are no longer allowed to be recognized separately under SFAS No. 141, have been included under reclassifications.

17 Goodwill

The changes during 2002 were as follows:

Book value as of January 1, 2002:	3,557
Changes in book value:	
Reclassifications	(16)
Acquisitions	80
Impairment losses	(19)
Translation differences	(409)
Changes in consolidation	(1)
Book value as of December 31, 2002:	**3,192**

The final appraisal value of goodwill, with respect to certain acquisitions in 2001, resulted in an adjustment to the amount originally assigned on a provisional basis. The reallocation of the purchase price to goodwill is reflected under 'reclassifications'. Additionally, amounts previously recognized as intangible assets with respect to acquired assembled workforce, which are no longer allowed to be recognized separately under SFAS No. 141, have been included under reclassifications (see also note 16).

The sale of the Health Care Products Group, a former Marconi entity in the Medical Systems sector, resulted in a write-off of previously allocated goodwill for an amount of EUR 19 million.

Refer to note 31 for a specification of goodwill by product sector.

18 Accrued liabilities

Accrued liabilities are summarized as follows:

	2002	2001
Personnel-related costs:		
- Salaries and wages payable	**610**	493
- Accrued holiday rights	**219**	215
- Other	**123**	90
Taxes:		
- Income tax payable	**268**	206
- Other taxes payable	**16**	30
Commission, freight, interest and rent payable	**475**	531
Deferred income	**402**	294
Advertising costs payable	**118**	110
IT costs payable	**111**	47
Warranties	**5**	30
Other liabilities	**967**	1,920
Total	**3,314**	3,966

19 Provisions

Provisions are summarized as follows:

	2002		2001	
	long-term	short-term	long-term	short-term
Pensions for defined-benefit plans (see note 20)	730	77	699	87
Other postretirement benefits (see note 20)	405	50	417	56
Post-employment benefits	93	36	85	26
Deferred tax liabilities (see note 4)	45	39	418	82
Restructuring (see note 2)	33	394	58	384
Obligatory severance payments	112	57	100	55
Replacement and guarantees	58	319	83	359
Other provisions	494	304	437	394
Total	1,970	1,276	2,297	1,443

Obligatory severance payments

The provision for obligatory severance payments cover the Company's commitment to pay employees a lump sum upon reaching retirement age, or upon the employees' dismissal or resignation. In the event that a former employee has passed away, the Company may have a commitment to pay a lump sum to the deceased employee's relatives.

Post-employment benefits

The provision for post-employment benefits covers benefits provided to former or inactive employees after employment but before retirement, including salary continuation, supplemental unemployment benefits and disability related benefits.

Replacement and guarantees

The provision for replacement and guarantees reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to products sold. The changes in the provision for replacement and guarantees are as follows:

	2002	2001	2000
Balance as of January 1,	442	428	413
Changes:			
Additions	382	349	322
Utilizations	(447)	(335)	(307)
Balance as of December 31,	377	442	428

Other provisions

Other provisions include provisions for expected losses on existing projects/orders totaling EUR 35 million (2001: EUR 32 million), for employee jubilee funds totaling EUR 104 million (2001: EUR 107 million) and environmental provisions of EUR 225 million (2001: EUR 238 million).

Certain of the Company's subsidiaries are parties to proceedings in connection with the clean-up of environmental matters, mostly related to closure of plants of the Company's discontinued chemical operations.

Philips does not believe, based upon the information available at this time, that the outcome of these matters will result in additional liability which would have a material adverse effect upon the Company's consolidated financial position.

The changes in the provisions for post-employment benefits, obligatory severance payments and other provisions are as follows:

Balance as of January 1, 2002	1,097
Changes:	
Additions	251
Utilization	(252)
Balance as of December 31, 2002	**1,096**

20 Pensions and postretirement benefits other than pensions

Employee pension plans have been established in many countries in accordance with the legal requirements, customs and the local situation in the countries involved. The majority of employees in Europe and North America are covered by defined-benefit plans. The benefits provided by these plans are based primarily on employees' years of service and compensation near retirement.

In addition to providing pension benefits, the Company provides other postretirement benefits, primarily retiree healthcare benefits, in certain countries.

Contributions are made by the Company, as necessary, to provide assets sufficient to meet the benefits payable to defined-benefit pension plan participants. These contributions are determined based upon various factors, including funded status, legal and tax considerations as well as local customs. The Company funds certain defined-benefit pension plans and other postretirement benefit plans as claims are incurred. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for both funded and unfunded defined-benefit pension plans with accumulated benefit obligations in excess of plan assets were EUR 5,769 million, EUR 5,353 million and EUR 4,233 million respectively as of December 31, 2002 (2001: EUR 1,063 million, EUR 970 million and EUR 179 million respectively).

Provided below is a table with a summary of the changes in the pension benefit obligations and defined pension plan assets for 2002 and 2001, and a reconciliation of the funded status of these plans to the amounts recognized in the consolidated balance sheets.

Also provided below is a table with a summary of the changes in the accumulated postretirement benefit obligations and plan assets for 2002 and 2001, and a reconciliation of the obligations to the amounts recognized in the consolidated balance sheets.

	2002	2001	2002	2001
	pension benefits		postretirement benefits	
Benefit obligation				
Benefit obligation at beginning of year	**19,064**	18,523	**657**	632
Service cost	**387**	351	**16**	12
Interest cost	**1,158**	1,105	**48**	43
Employee contributions	**27**	28	–	–
Actuarial (gains) and losses	**(110)**	(51)	**168**	34
Plan amendments	**33**	6	–	–
Settlements	**(41)**	(8)	**(2)**	–
Changes in consolidations	**518**	3	**10**	(29)
Benefits paid	**(1,070)**	(1,015)	**(46)**	(47)
Exchange rate differences	**(731)**	125	**(87)**	14
Miscellaneous	**2**	(3)	–	(2)
Benefit obligation at end of year	**19,237**	19,064	**764**	657
Plan assets				
Fair value of plan assets at beginning of year	**20,594**	22,505	–	17
Actual return on plan assets	**(2,112)**	(996)	–	1
Employee contributions	**27**	28	–	–
Employer contributions (refunds)	**88**	(205)	–	2
Settlements	**(36)**	(11)	–	–
Changes in consolidations	**493**	54	–	(15)
Benefits paid	**(1,001)**	(923)	–	(3)
Exchange rate differences	**(651)**	143	–	(2)
Miscellaneous	–	(1)	–	–
Fair value of plan assets at end of year	**17,402**	20,594	–	–
Funded status	**(1,835)**	1,530	**(764)**	(657)
Unrecognized net transition (asset) obligation	**(15)**	(82)	**103**	122
Unrecognized prior service cost	**169**	161	**3**	6
Unrecognized net (gain) loss	**2,619**	(688)	**203**	56
Net balances	**938**	921	**(455)**	(473)
Classification of the net balances is as follows:				
- Prepaid pension costs under other non-current assets	**1,384**	1,740		
- Accrued pension costs under other non-current liabilities	**(352)**	(52)		
- Provisions for pensions under provisions	**(807)**	(786)		
- Intangible assets	**181**	1		
- Accumulated other comprehensive income	**532**	18		
	938	921		

The weighted average assumptions underlying the pension computation were as follows:

	2002	2001
Discount rate	5.7%	6.1%
Rate of compensation increase	2.9%	3.4%
Expected return on plan assets	6.5%	7.2%

The components of net periodic pension costs of major defined-benefit plans were as follows:

	2002	2001	2000
Service cost-benefits earned during the period	387	351	366
Interest cost on the projected benefit obligation	1,158	1,105	1,090
Expected return on plan assets	(1,341)	(1,625)	(1,535)
Net amortization of unrecognized net transition assets	(67)	(68)	(98)
Net actuarial gain recognized	(133)	(265)	(231)
Amortization of prior service cost	32	31	21
Settlement (gain) loss	4	4	(106)
Curtailment loss	1	1	1
Net periodic pension cost	41	(466)	(492)

The Company also sponsors defined-contribution and similar-type plans for a significant number of salaried employees. The total cost of these plans amounted to EUR 89 million in 2002 (2001: EUR 55 million, 2000: EUR 70 million).

The components of the net periodic cost of postretirement benefits other than pensions are:

	2002	2001	2000
Service cost-benefits earned during the period	16	12	13
Interest cost on accumulated postretirement benefit obligation	48	43	43
Expected return on plan assets	–	(1)	(2)
Amortization of unrecognized transition obligation	11	11	13
Net actuarial loss recognized	7	1	1
Curtailment loss	–	–	22
Net periodic cost	82	66	90

The accumulated postretirement benefit obligation was determined using a weighted average discount rate of 6.4% (2001: 7.0%) and an assumed compensation increase, where applicable, of 4.6% (2001: 4.6%). For measurement purposes, the rate of increase in per capita healthcare costs is assumed to be on average 7.8% for 2003, reaching 5.5% by the year 2006. Healthcare cost trend assumptions have a significant effect on the amounts reported for other postretirement benefits. Increasing the assumed healthcare cost trend rate by 1 percentage point would increase the accumulated postretirement benefit obligation as of December 31, 2002 by approximately EUR 81 million and increase the net periodic postretirement benefit cost for 2002 by EUR 10 million. Conversely, decreasing the assumed healthcare cost trend by 1 percentage point would decrease the accumulated postretirement benefit obligation as of December 31, 2002 by approximately EUR 66 million and decrease the net periodic postretirement benefit cost for 2002 by EUR 9 million.

21 Other current liabilities

Other current liabilities are summarized as follows:

	2002	2001
Advances received from customers on orders not covered by work in process	**116**	192
Other taxes including social security premiums payable	**290**	381
Other short-term liabilities	**285**	240
Total	**691**	813

22 Short-term debt

	2002	2001
Short-term bank borrowings	**352**	552
Commercial paper	**10**	521
Other short-term loans	**60**	18
Current portion of long-term debt	**195**	180
Total	**617**	1,271

During 2002 the weighted average interest rate on the bank borrowings was 4.2% (2001: 5.5% and 2000: 5.7%), and on commercial paper 3.5% (2001 : 3.9%).
In July 2002, Philips entered into a USD 3.5 billion revolving credit facility with a consortium of banks; no drawings have been made under this facility. The facility, which has a five-year maturity, replaces an existing USD 2.5 billion revolving credit facility which had been in place since July 1996 and was never drawn upon by the Company. The commitment fees amounted to EUR 10 million and were charged to financial income and expenses.

23 Long-term debt

	range of interest rates	average rate of interest	amount outstanding	due in 2003	due after 2003	due after 2007	average remaining term (in years)	amount out-standing 2001
Convertible debentures	1.1	1.1	145	–	145	–	3.0	134
Other debentures	4.2-8.8	5.9	6,219	139	6,080	2,973	5.0	6,253
Private financing	2.5-3.0	2.8	2	1	1	–	4.0	2
Bank borrowings	1.3-14.0	7.5	156	46	110	91	4.4	200
Liabilities arising from capital lease transactions	1.8-10.4	6.5	8	2	6	–	2.5	15
Other long-term debt	2.0-10.2	5.1	157	7	150	32	3.8	171
Total		**5.8**	**6,687**	**195**	**6,492**	**3,096**		6,775
Corresponding data previous year		6.0	6,775	180	6,595	3,197		

The following amounts of long-term debt as of December 31, 2002 are due in the next five years:

2003	195
2004	2,386
2005	612
2006	325
2007	73
	3,591
Corresponding amount previous year	3,578

In the Netherlands, Philips issues personnel debentures with a 5-year right of conversion into common shares of Royal Philips Electronics. Personnel debentures which were issued after December 31, 1998 may not be converted within a period of 3 years after the date of issue. These personnel debentures are available to most employees and are purchased by them with their own funds. The personnel debentures are redeemable on demand, but in practice are considered to be a form of long-term financing. The personnel debentures become non-convertible debentures at the end of the conversion period. At such time, they will be reported as other long-term debt.
At December 31, 2002 an amount of EUR 145 million (2001: EUR 134 million) of personnel debentures was outstanding, with an average conversion price of EUR 29.21 and an average interest rate of 1.1%. The conversion price varies between EUR 13.84 and EUR 49.50, with various conversion periods ending between January 1, 2003 and December 31, 2007.

Philips had two 'putable' USD bonds outstanding at year-end 2002 for a total amount of EUR 256 million. The investors may require repayment in one specific month during the lifetime of the respective bonds. Assuming that investors require repayment at the relevant put dates, the average remaining tenor of the total outstanding long-term debt was 4.2 years, compared to 5.2 years in 2001. However, assuming that the 'putable' bonds will be repaid at maturity, the average remaining tenor at the end of 2002 was 4.9 years, compared to 6.1 years at the end of 2001. Long-term debt as a proportion of the total debt at the end of 2002 stood at 91%, compared to 84% at the end of 2001.

During 2002, Philips placed a eurobond issue for a total amount of EUR 300 million, maturing in August 2005.

Secured liabilities

Certain portions of long-term and short-term debt have been secured by collateral as follows:

	amount of the debt	collateral	
		tangible fixed assets	other assets
Institutional financing	17	35	13
Other debts	3	5	–
Total	**20**	**40**	**13**
Previous year	37	65	90

24 Other non-current liabilities

Other non-current liabilities are summarized as follows:

	2002	2001
Accrued pension costs	**352**	52
Sale and lease-back deferred income	**108**	38
Income tax payable	**114**	122
Other liabilities	**29**	–
	603	212

25 Commitments and contingent liabilities

Long-term operating lease commitments totaled EUR 879 million in 2002 (2001: EUR 768 million). These leases expire at various dates during the next 20 years. The payments that fall due in connection with these obligations during the coming five years are:

2003	166
2004	140
2005	137
2006	125
2007	80
Later	231

The long-term operating leases are mainly related to the rental of buildings. A number of these leases originate from sale-and-lease-back arrangements. In 2002 the Company entered into two sale and operational lease-back arrangements in the Netherlands for office buildings. These buildings were sold for an aggregate amount of EUR 166 million. In 2001 there were two sale and operational lease-back arrangements for an aggregate amount of EUR 89 million in the Netherlands and the USA. The rental periods are 8 and 5 years for those in 2002 and 10 and 20 years for those in 2001 but can be prolonged for all contracts. The rental payments are fixed. The rental payments for 2002 totaled EUR 26 million (2001: EUR 0.2 million, as both transactions took place in the second half of December 2001).
The remaining minimum payments in millions of euros are as follows:

2003	27
2004	24
2005	22
2006	18
2007	13
Later	70

The Company has subleases with total expected revenues of EUR 52 million during the coming five years as follows:

2003	9
2004	9
2005	8
2006	7
2007	7
Later	12

Philips has no commitment or involvement with previously owned property other than the lease agreements.

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46 'Consolidation of Variable Interest Entities'. Based on this Interpretation it is reasonably possible that the entity which is being used for the first phase of the High Tech Campus will qualify as a Variable Interest Entity to be consolidated under this Interpretation. This Interpretation requires that such entity be consolidated, if the Company is the primary beneficiary of the expected residual returns if they occur, as from the third quarter of 2003.

Guarantees

During 1999 the Company entered into agreements for the construction of the first phase of the High Tech Campus in the Netherlands. Upon completion of the first phase, the buildings will be leased to Philips until 2007. Commitments have been entered into, and a guarantee has been issued, for all present and future monetary payment obligations of the lessee, Philips Electronics Nederland B.V., with a maximum amount of EUR 130 million. The actual contingent liability outstanding at year-end from this guarantee is EUR 115 million (2001: EUR 99 million), which is the amount spent so far. The first lease payments were due in 2001, when the first premises became available for use.

Guarantees given with regard to unconsolidated companies and third parties amounted to EUR 906 million (2001: EUR 792 million). The amount of conditional liabilities was EUR 127 million (2001: EUR 8 million). The guarantees expire as follows:

In 2003	278
In 2004-2007	577
After 2007	51

A guarantee amounting to USD 200 million issued to the financing parties for the facility agreement they issued to our unconsolidated joint venture LG.Philips Displays in the amount of USD 2 billion. The guarantee has been issued in May 2002 and expires on December 31, 2004 or earlier if the joint venture meets the covenants of the facility agreement. Under the guarantee the Company guarantees and shall pay, upon failure to pay by the joint venture, all principal, interest and fees payable by the joint venture for an amount of USD 100 million, and agrees to indemnify and hold harmless the financing parties on demand from any loss in respect of principal, interest and fees payable by the joint venture under the facility agreement for an amount of USD 100 million. The guaranteed amount of USD 200 million will be reduced by an amount of USD 50 million, maximum, for the sum of (a) any subordinated debt that has been advanced by the Company to the joint venture, and (b) the amount by which an equity injection in the joint venture paid by the Company exceeds USD 125 million.

A guarantee in the amount of USD 80 million is related to a loan by the European Investment Bank to Philips Semiconductor Philippines Incorporated, a Philips' subsidiary incorporated in the Philippines. The guarantee is for commercial risk only and is to be amortized in 10 equal semi-annual payments, commencing in January 2005. The guarantee further requires the Company to provide a bank guarantee from an A2-rated bank, to replace the Company's commercial guarantee, in the event of downgrading to BBB+ (or equivalent Baa1) by any of S&P, Moody's or Fitch IBCA rating agencies for the most recent Koninklijke Philips Electronics N.V. unsecured and unsubordinated medium or long-term capital market securities, provided only that the downgrading is simultaneous with a negative outlook statement from the same agency, or, in another case, if the Company's securities cease to be rated by all of S&P, Moody's and Fitch IBCA rating agencies.

Litigation

Royal Philips Electronics and certain of its Group companies are involved as plaintiff or defendant in litigation relating to such matters as competition issues, commercial transactions, product liability, participations and environmental pollution. One pending litigation includes claims by Volumetrics, Inc. relating to the decision of a Philips Ultrasound business not to collaborate with or acquire Volumetrics in view of Philips Medical Systems' acquisition of Agilent Technologies, Inc.'s Healthcare Solutions Group. On January 22, 2003, a jury in Raleigh, North Carolina delivered a verdict of approximately USD 152 million against a Philips subsidiary. The judgment 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.
While an ultimate unfavorable judgment could have a material effect on the Company's consolidated results of operations in the period of resolution, Management does not believe that an ultimate unfavorable judgment will have a material adverse effect on the Company's consolidated financial position.

Further judicial proceedings are pending in the United States, relating primarily to the activities of a Philips' subsidiary prior to 1981, involving allegations of personal injury relating to alleged asbestos exposure. The claims generally relate to asbestos used in the manufacture of unrelated companies' products in the United States and frequently involve claims for substantial general and punitive damages. The number of pending claims involving the Company's subsidiary increased from approximately 50 at the end of 2001 to approximately 500 at the end of January 2003. While management believes there are meritorious defenses to these claims, certain of these cases have been settled for amounts management considered reasonable given the facts and circumstances of each case. Further, although the final outcome of matters in litigation cannot be determined due to a number of variables, after reviewing the proceedings that are currently pending (including the provisions made, number of claims, estimated probable outcomes, reasonably anticipated costs and expenses, and uncertainties regarding the availability and limits of insurance), management believes that the final outcome of any of the pending proceedings, or all of them combined, will not have a material adverse effect on the consolidated financial position or results of operations of the Company. If the general trends towards (i) higher costs of resolving individual asbestos personal injury cases, (ii) increasing numbers of cases, or (iii) the naming of more peripheral defendants, such as the Company's subsidiary in such cases continue, or if insurance coverage is ultimately less than anticipated, the Company's consolidated financial position and results of operations could be materially and adversely affected.

26 Stockholders' equity

Priority shares

There are ten priority shares. During 2002, Messrs. F.J. Philips and H.A.C. van Riemsdijk each sold one priority share to the Dr. A.F. Philips Stichting, as a result of which it now holds all ten priority shares.
The issuance of shares or rights to shares, cancellation of shares, amendments to the Articles of Association and the liquidation of the Company need approval of the priority shareholders, who also make a binding recommendation for the appointment of members of the Board of Management and the Supervisory Board.

Preference shares

The 'Stichting Preferente Aandelen Philips' has been granted the right to acquire preference shares in the Company. Such right has not been exercised.

Option rights

The Company has granted stock options on shares of Royal Philips Electronics at original exercise prices equal to market prices of the shares at the date of grant (see note 28).

Treasury shares

Royal Philips Electronics' shares which have been repurchased and are held in treasury for delivery upon exercise of options and convertible personnel debentures are accounted for in stockholders' equity. Treasury shares are recorded at cost, representing the market price on the acquisition date. When issued, shares are removed from treasury stock on a FIFO basis.
In order to reduce potential dilution effects, a total of 3,128,353 shares were acquired during 2002 at an average market price of EUR 32.97 per share, totaling EUR 103 million, and a total of 4,933,833 shares were delivered at an average exercise price of EUR 18.11, totaling EUR 90 million.
A total of 40,092,469 shares were being held by Group companies at December 31, 2002 (2001: 41,897,949 shares), acquired at an aggregate cost of EUR 1,307 million.

Retained earnings

A cash distribution of EUR 0.36 per common share will be proposed to the General Meeting of Shareholders, which will result in a reduction of retained earnings by EUR 459 million.

27 Related party transactions

In the normal course of business, Philips purchases and sells goods and services to various related parties in which Philips holds a 50% or less equity interest. These transactions are generally conducted on an arm's length basis with terms comparable to transactions with third parties. In 2002, purchases of goods and services from related parties totaled EUR 559 million, whereas sales of goods and services to related parties totaled EUR 209 million. At December 31, 2002, receivables from related parties were EUR 63 million; payables to related parties were EUR 109 million.

As of December 31, 2002, Philips held redeemable preferred shares of TSMC for an amount of EUR 374 million or 1.3 billion shares. These will be redeemed in the second quarter of 2003.

In November 2002, Picker Financial Group, an affiliate acquired in the Marconi acquisition in 2001, sold approximately EUR 140 million receivables to Philips Medical Capital, in which the Company has a 40% equity interest.

28 Stock-based compensation

The Company has granted stock options on its common shares to members of the Group Management Committee, Philips Executives and certain non-executives. The purpose of the stock option plans is to align the interests of management with those of shareholders by providing additional incentives to improve the Company's performance on a long-term basis, thereby increasing shareholder value. Under the Company's plans, options are granted at fair market value on the date of grant. Exercise of all options is restricted by the Company's rules on insider trading.

In 2002, the Company granted fixed stock options that expire after 10 years. Generally, the options vest after 3 years; however, a limited number of options granted to certain employees of acquired businesses contain accelerated vesting.

In prior years, fixed and variable (performance) options were issued with terms of five or ten years, vesting one to three years after grant.

The actual number of variable (performance) stock options granted in 2000 and 2001 that are ultimately eligible to vest is dependent upon Total Shareholder Return of Philips, as defined, in comparison with a peer group of multinationals over a three-year period. During the year it was determined that 25% of the variable (performance) options that were issued in 2000 will not be eligible for vesting in 2003.

In contrast to the years 2000 and 2001, when variable (performance) stock options were issued, the number of options granted in 2002, already consider the performance of the Company versus a peer group of multinationals.

USD-denominated stock options are granted to employees in the USA only.

Under the terms of employee stock purchase plans established by the Company in various countries, substantially all employees in those countries are eligible to purchase a limited number of shares of Philips stock at discounted prices through payroll withholdings, of which the maximum ranges from 8.5% to 10% of total salary. Generally, the discount provided to the employees is 15%. In the USA, the purchase price equals the lower of 85% of the closing price at the beginning or end of quarterly stock purchase periods. A total of 1,722,575 shares were sold in 2002 under the plan at an average price of EUR 23.69 (2001: 955,668 shares, at a price of EUR 24.29, 2000: 54,034 shares, at a price of EUR 39.23).

In the Netherlands, Philips issued personnel debentures with a 5-year right of conversion into common shares of Royal Philips Electronics. In 2002, 515,309 shares were issued in conjunction with conversions at an average price of EUR 14.52 (2001: 415,038 shares at an average price of EUR 9.08, 2000: 949,312 shares at an average price of EUR 11.44).

The shares subject to the stock option and stock purchase plans are partly covered by shares held in treasury.

The Company accounts for stock-based compensation using the intrinsic value method. Accordingly, no compensation has been recorded for the fixed stock options granted, nor for the US stock purchase plan. Compensation income of EUR 5 million in 2002 (2001: expense of EUR 5 million, 2000: nil) was recognized for the performance stock options granted based on the market value of the shares at December 31, 2002.
Additionally, approximately EUR 1 million was recorded as an expense for shares purchased through certain compensatory stock purchase plans.

The pro forma net income and earnings per share data, calculated as if the fair value of the options granted to option holders would have been considered as compensation costs, is as follows:

	2002	2001	2000
Net income(loss):			
As reported	(3,206)	(2,475)	9,662
Add: Stock-based compensation expense included in reported net income, net of related tax	(5)	5	–
Deduct: Stock-based compensation expense determined under the fair-value-based method, net of related tax	(147)	(96)	(92)
Pro forma	(3,358)	(2,566)	9,570
Basic earnings per share:			
As reported	(2.51)	(1.94)	7.36
Pro forma	(2.63)	(2.01)	7.29
Diluted earnings per share:			
As reported	(2.51)	(1.94)	7.28
Pro forma	(2.63)	(2.01)	7.21

As noted above, the actual number of performance stock options (granted in 2000 and 2001) that are ultimately eligible to vest is dependent upon Total Shareholder Return of Philips, as defined in comparison with a peer group of multinationals over a three-year period. To the extent that the number of stock options that ultimately vest differs from the assumptions underlying the pro forma results presented above, future pro forma net income will be adjusted. Pro forma net income may not be representative of that to be expected in future years.

In accordance with SFAS No. 123, the fair value of stock options granted is required to be based upon a statistical option valuation model. Since the Company's stock options are not traded on any exchange, employees can receive no value nor derive any benefit from holding these stock options without an increase in the market price of Philips' stock. Such an increase in stock price would benefit all shareholders commensurately.

The fair value of the Company's 2002, 2001 and 2000 option grants was estimated using a Black-Scholes option pricing model and the following assumptions:

	2002	2001	2000
			(EUR -denominated)
Risk-free interest rate	4.70%	4.66%	5.06%
Expected dividend yield	1.2%	1.2%	0.7%
Expected option life	5 yrs	5 yrs	4 yrs
Expected stock price volatility	53%	49%	46%

	2002	2001	2000
			(USD-denominated)
Risk-free interest rate	4.65%	4.77%	6.26%
Expected dividend yield	1.2%	1.2%	0.9%
Expected option life	5 yrs	5 yrs	5 yrs
Expected stock price volatility	49%	49%	43%

The assumptions were used for these calculations only and do not necessarily represent an indication of Management's expectations of future developments.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The Company's employee stock options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

The following table summarizes information about the stock options outstanding at December 31, 2002:

Fixed option plans

	options outstanding			options exercisable	
	number outstanding at Dec. 31, 2002	exercise price per share	weighted average remaining contractual life (years)	number exercisable at Dec. 31, 2002	weighted average exercise price per share
		(price in EUR)			(price in EUR)
1998	1,753,800	11.57 – 21.02	0.2	1,753,800	16.49
1999	2,863,800	15.76 – 23.01	1.2	2,863,800	16.12
2000	3,284,700	42.03 – 53.75	7.3	–	
2001	5,147,197	24.35 – 37.60	8.3	–	
2002	10,242,613	17.19 – 34.78	9.2	–	
		(price in USD)			(price in USD)
1998	1,261,211	12.94 – 23.59	5.3	1,261,211	17.38
1999	1,952,943	22.24 – 35.34	6.4	1,952,010	23.10
2000	2,930,660	36.65 – 49.71	7.4	–	
2001	5,359,487	22.12 – 34.50	8.4	931,605	34.50
2002	11,098,230	16.88 – 30.70	9.3	–	
	45,894,641			8,762,426	

Variable plans

		(price in EUR)			(price in EUR)
2000	2,461,575	42.03 – 53.75	7.3	–	
2001	4,749,847	24.35 – 37.60	8.2	–	
		(price in USD)			(price in USD)
1995-1997	1,151,004	7.50 – 14.20	2.0	1,151,004	7.81
2000	2,172,495	36.65 – 49.71	7.4	–	
2001	3,451,187	22.12 – 34.50	8.3	–	
	13,986,108			1,151,004	

A summary of the status of the Company's stock option plans as of December 31, 2002, 2001 and 2000 and changes during the years then ended is presented below:

Fixed option plans

	2002		2001		2000	
	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)
Outstanding at the beginning of the year	**16,091,485**	**27.20**	12,305,150	22.75	13,261,600	14.27
Granted	**10,511,828**	**31.95**	5,282,385	33.22	3,445,850	43.52
Exercised	**(2,172,300)**	**12.86**	(1,330,000)	9.82	(4,172,484)	13.56
Forfeited	**(1,138,903)**	**25.67**	(166,050)	27.46	(229,816)	11.61
Outstanding at the end of the year	**23,292,110**	**30.76**	16,091,485	27.20	12,305,150	22.75
Weighted average fair value of options granted during the year in EUR	14.90		14.75		17.42	
		(price in USD)		(price in USD)		(price in USD)
Outstanding at the beginning of the year	**13,009,155**	**29.14**	7,865,003	31.17	4,996,988	20.66
Granted	**11,697,253**	**29.58**	6,261,103	26.99	4,015,797	42.25
Exercised	**(325,688)**	**19.58**	(183,325)	19.21	(665,900)	19.06
Forfeited	**(1,778,189)**	**31.26**	(933,626)	33.71	(481,882)	32.76
Outstanding at the end of the year	**22,602,531**	**29.34**	13,009,155	29.14	7,865,003	31.17
Weighted average fair value of options granted during the year in USD	13.01		11.90		18.38	

Variable plans

	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)
Outstanding at the beginning of the year	**8,256,085**	**37.87**	3,426,350	43.53	–	–
Granted	**–**	**–**	4,899,485	33.91	3,445,850	43.52
Exercised	**–**	**–**	–	–	–	–
Forfeited	**(224,138)**	**38.67**	(69,750)	37.55	(19,500)	42.92
Canceled *	**(820,525)**					
Outstanding at the end of the year	**7,211,422**	**37.20**	8,256,085	37.87	3,426,350	43.53
Weighted average fair value of options granted during the year in EUR	N.A.		14.75		17.42	
		(price in USD)		(price in USD)		(price in USD)
Outstanding at the beginning of the year	**8,784,189**	**29.48**	5,363,954	31.97	2,787,200	7.14
Granted	**–**	**–**	4,225,903	26.97	4,015,797	42.25
Exercised	**(328,348)**	**4.47**	(72,262)	6.54	(1,174,348)	7.28
Forfeited	**(956,990)**	**34.43**	(733,406)	35.36	(264,695)	36.09
Canceled *	**(724,165)**					
Outstanding at the end of the year	**6,774,686**	**33.15**	8,784,189	29.48	5,363,954	31.97
Weighted average fair value of options granted during the year in USD	N.A.		11.90		18.38	

* During the year it was determined that 75% of the 2000 performance stock options will be eligible for vesting in 2003.

29 Information on remuneration of the individual members of the Board of Management and the Supervisory Board

Remuneration

Board of Management

Remuneration and pension charges relating to the members of the Board of Management amounted to EUR 3,984,436 (2001: EUR 3,043,533, 2000: EUR 4,442,733). An additional amount of EUR 298,258 was paid in the form of special allowances in 2002. When pension rights are granted to (former) members of the Board of Management, necessary payments (if insured) and all necessary provisions are made (also for the self-administered pensions) in accordance with the applicable accounting principles.
In 2002, no (additional) pension benefits were granted to former members of the Board of Management.

In 2002, the present members of the Board of Management were granted 489,600 stock option rights (2001: 360,000 stock option rights, 2000: 500,000 stock option rights). At year-end 2002, the members of the Board of Management held 1,410,940 stock option rights (year-end 2001: 1,564,000) at a weighted average exercise price of EUR 30.06 (year-end 2001: EUR 24.20).

The remuneration in euros of the individual members of the Board of Management was as follows:

	2002			
	salary	bonus*	total cash	other compensation [6]
G.J. Kleisterlee	807,069	–	807,069	25,576
J.H.M. Hommen	672,573	–	672,573	28,643
G.H.A. Dutiné [4], [7]	375,000	–	375,000	208,686
A. Huijser [4]	337,500	–	337,500	12,692
A.P.M. van der Poel	642,439	–	642,439	17,231
J.W. Whybrow [5]	158,823	149,802	308,625	5,430
Total	2,993,404	149,802	3,143,206	298,258

	2001		
	salary	bonus*	total cash
G.J. Kleisterlee [1]	721,775	248,520	970,295
J.H.M. Hommen	635,292	370,625	1,005,917
A.P.M. van der Poel	635,292	355,310	990,602
J.W. Whybrow	635,292	354,927	990,219
C. Boonstra [2]	313,826	562,687	876,513
A. Baan [3]	153,349	79,638	232,987
Total	3,094,826	1,971,707	5,066,533

	2000		
	salary	bonus*	total cash
G.J. Kleisterlee [1]	400,839	–	400,839
J.H.M. Hommen	612,603	432,906	1,045,509
A.P.M. van der Poel	612,603	318,327	930,930
J.W. Whybrow	612,603	302,671	915,274
C. Boonstra	907,560	900,300	1,807,860
A. Baan	612,603	218,382	830,985
Subtotal	3,758,811	2,172,586	5,931,397
Former member	–	70,336	70,336
Total	3,758,811	2,242,922	6,001,733

* The bonuses paid are related to the level of performance achieved in the previous year.
1) Bonus figures 2001 relate to period April-December 2000; salary figure 2000 related to period April-December 2000.
2) Salary figures 2001 relate to period January-April 2001.
3) Salary figures 2001 relate to period January-March 2001.
4) Salary figures 2002 relate to period April-December 2002.
5) Salary figures 2002 relate to period January-March 2002.
6) The Company paid social security premiums totaling EUR 18,716 (EUR 3,940 per person per year).
The stated amounts concern (share of) allowances to members of the Board of Management that can be considered as remuneration. In a situation where such a share of an allowance can be considered as (indirect) remuneration (for example, private use of the company car), then this share is both valued and accounted for here. The method employed by the fiscal authorities in the Netherlands is the starting point for the value stated.
7) Includes relocation and school costs for Mr Dutiné and his family: EUR 185,237.

The table below gives an overview of the interests of the members of the Board of Management under the stock option plans of Royal Philips Electronics.

	number of options					amounts in euros		
	as of Jan. 1, 2002	granted during 2002	exercised during 2002	cancel-led *	as of Dec. 31, 2002	exercise price	share price on exercise date	expiry date
G.J. Kleisterlee	12,000 b)		12,000			9.40	29.35 c)	13.02.2002
	12,000 b)				12,000 b)	16.66		12.02.2003
	60,000 b)				60,000 b)	15.97		11.02.2004
	60,000 a/b)			7,500	52,500 b)	42.24		17.02.2010
	120,000 a)				120,000 a)	37.60		08.02.2011
	–	115,200			115,200	30.17		07.02.2012
J.H.M. Hommen	480,000		480,000		–	9.84	29.35 c)	13.02.2002
	80,000				80,000	17.10		12.02.2003
	80,000				80,000	16.41		11.02.2004
	80,000 a)			10,000	70,000	42.24		17.02.2010
	80,000 a)				80,000 a)	37.60		08.02.2011
	–	96,000			96,000	30.17		07.02.2012
G.H.A. Dutiné	– b/d)	124,800			124,800 b/d)	30.17		07.02.2012
A. Huijser	21,840 b)				21,840 b)	9.87		21.12.2004
	16,000 b)				16,000 b)	16.45		12.02.2003
	24,000 b)				24,000 b)	15.76		11.02.2004
	40,000 a/b)			5,000	35,000 b)	42.03		17.02.2010
	40,000 a/b)				40,000 a/b)	37.60		08.02.2011
		76,800			76,800	30.17		07.02.2012
A.P.M. van der Poel	20,000		20,000		–	17.10	32.10	12.02.2003
	80,000				80,000	16.41		11.02.2004
	80,000 a)			10,000	70,000	42.24		17.02.2010
	80,000 a)				80,000 a)	37.60		08.02.2011
	–	76,800			76,800	30.17		07.02.2012
Total	1,465,840	489,600	512,000	32,500	1,410,940			

a) 50% fixed options and 50% performance-related options
b) awarded before date of appointment as a member of the Board of Management
c) shares (partly) not sold but (partly) retained in depot with bank
d) partly sign-on bonus

* During the year it was determined that 75% of the 2000 performance related stock options will be eligible for vesting in 2003.

The Supervisory Board and the Board of Management have decided to adjust upwards the exercise price of all options granted to, but not yet exercised by, members of the Board of Management as of May 29, 1999 by EUR 0.437 and as of July 31, 2000 by EUR 0.21 per common share in connection with the 8% share reduction program and the 3% share reduction program effected mid-1999 and mid-2000 respectively. This increase is incorporated in the above table.

The total pension charges of the members of the Board of Management in 2002 amount to EUR 841,230 (pension credits in 2001 and 2000 of EUR 2,023,000 and EUR 1,559,000 respectively).

The vested pension benefits of individual members of the Board of Management are as follows (in euros):

	age at December 31, 2002	ultimate retirement age	increase in accrued pension during 2002	accumulated annual pension as at December 31, 2002	pension premium 2002 paid by employer [1]	pension premium 2002 paid by employee	pension charges 2002
G.J. Kleisterlee	56	62	97,648	414,492	0	44,988	33,942
J.H.M. Hommen	59	62	23,379	118,363	0	24,821	428,460[3]
G.H.A. Dutiné	50	62	9,495	9,495	0	28,869	231,794[3]
A. Huijser	56	62	84,903	248,276	0	22,872	9,479
A.P.M. van der Poel	54	62	16,228	254,307	0	36,540	64,079
Total							767,754[2]

1) Due to pension premium holiday no contribution was made.
2) Mr J.W. Whybrow for the period January – March 2002 EUR 73,476 not included.
3) Relatively high pension charges due to unfunded conditional pension rights that were granted at the start of the employment to compensate unvested pension rights with the former employer and the relatively low number of service years. In 2003 these pension liabilities will be transferred to an insurance company.

See note 28 to the financial statements for further information on stock options.

Supervisory Board

The remuneration of the members of the Supervisory Board amounted to EUR 315,378 (2001: EUR 331,260, 2000: EUR 376,637); former members received no remuneration.

The annual remuneration for individual members is EUR 40,840 and for the Chairman EUR 74,874. Additionally, the membership of committees of the Supervisory Board is compensated by an amount of EUR 4,538 per year per committee. At year-end 2002, the present members of the Supervisory Board held no stock options.

During 2002 the individual members of the Supervisory Board received, by virtue of the positions they held, the following remuneration (in euros):

		2002	
	member-ship	committees	total
L.C. van Wachem	74,874	9,076	83,950
W. de Kleuver	40,840	9,076	49,916
L. Schweitzer	40,840	4,538	45,378
R. Greenbury	40,840	4,538	45,378
J.M. Hessels	40,840	4,538	45,378
K.A.L.M. van Miert	40,840	4,538	45,378
	279,074	36,304	315,378

	2001		
	membership	committees	total
L.C. van Wachem	74,874	9,076	83,950
W. de Kleuver	40,840	9,076	49,916
W. Hilger (Jan./March)	20,420	2,269	22,689
L. Schweitzer	40,840	–	40,840
R. Greenbury	40,840	4,538	45,378
J.M. Hessels	40,840	4,538	45,378
K.A.L.M. van Miert	40,840	2,269	43,109
	299,494	31,766	331,260

	2000		
	membership	committees	total
L.C. van Wachem	74,874	9,076	83,950
W. de Kleuver	40,840	9,076	49,916
W. Hilger	40,840	9,076	49,916
L. Schweitzer	40,840	–	40,840
R. Greenbury	40,840	4,538	45,378
J.M. Hessels	40,840	3,403	44,243
K.A.L.M. van Miert	40,840	–	40,840
C.J. Oort (Jan./March)	20,420	1,134	21,554
	340,334	36,303	376,637

Supervisory Board members' and Board of Management members' interests in Philips shares

Members of the Supervisory Board and of the Board of Management are not allowed to take any interests in derivative Philips securities.

	number of shares	
	as of December 31, 2002	as of December 31, 2001
L.C. van Wachem	17,848	17,848
W. de Kleuver	4,131	–
L. Schweitzer	1,070	1,070
G.J. Kleisterlee	41,137	27,200
J.H.M. Hommen	314,131	–
A. Huijser	25,227	23,260

The above statement does not specify ownership of convertible personnel debentures, which are held under a scheme that since 1998 has no longer been applicable to members of the Board of Management.

30 Financial instruments and risks

Currency fluctuations may impact Philips' financial results. Furthermore, Philips is exposed to interest rate risk, equity price risk, commodity price risk, credit risk and country risk.

The Company does not purchase or hold derivative financial instruments for trading purposes.

Currency risk

The Company has a structural currency mismatch between costs and revenues, as a substantial proportion of its production, administration and research & development costs is denominated in euros, while a substantial proportion of its revenues is denominated in US dollars. Consequently, fluctuations in the exchange rate of the US dollar against the euro can have a material impact on Philips' financial results. In particular, a relatively strong US dollar during any reporting period will improve Philips' income from operations, while a weaker US dollar will worsen it.

The Company is exposed to currency risk in the following areas:

- transaction exposures, such as both existing and forecasted sales and purchases and payables/receivables resulting from such transactions;
- translation exposure of investments in foreign entities (including results);
- exposure of non-functional-currency-denominated debt;
- exposure of non-functional-currency-denominated equity investments.

All businesses must identify and measure their exposures from material transactions denominated in currencies other than their own functional currency. It is Philips' policy that significant transaction exposures are hedged by the businesses. Generally, the maximum tenor of these hedges is 12 months. Translation exposure on investments in consolidated foreign entities is not hedged.

Financing of subsidiaries is generally done in the functional currency of the borrowing entity. If the financing currency is not the functional currency of the business, then in principle the entity's exposure to foreign exchange risks is hedged, unless it is restricted for regulatory reasons.

Philips does not currently hedge the foreign exchange exposure arising from equity investments.

The Company uses foreign exchange derivatives to manage its currency risk. The inherent risk related to the use of these derivatives is outlined below.

An instantaneous 10% strengthening or weakening of non-euro currencies against the euro from their levels at December 31, 2002, with all other variables held constant, would result in an estimated change in the fair value of the Company's financial instruments of EUR 71 million, compared with EUR 43 million in 2001. For the purpose of this analysis, financial instruments consist of debt, liquid assets and derivative financial instruments, leading to the following sensitivity:

	Sensitivity to a 10% increase in the euro versus non-euro currencies
Debt	(329)
Liquid assets	0
Derivatives	400
Total	71

The US dollar and the pound sterling account for a significant percentage of the above exposure. An instantaneous 10% increase of the euro against the US dollar from their levels at December 31, 2002, with all other variables held constant, and an instantaneous 10% increase of the euro against the pound sterling from their levels at December 31, 2002, with all other variables held constant, would result in the following changes in the fair value of the Company's financial derivatives.

	Sensitivity to a 10% increase in the euro versus the US dollar	Sensitivity to a 10% increase in the euro versus the pound sterling
Derivatives related to debt/liquid assets	291	–
Derivatives related to transactions	26	27
Total	317	27

Further, the Company is exposed to movements of the Taiwanese dollar relative to the US dollar. An instantaneous 10% increase of the Taiwanese dollar against the US dollar from their levels at December 31, 2002, with all other variables held constant, would result in the following changes in the fair value of the Company's financial derivatives.

	Sensitivity to a 10% increase in the Taiwanese dollar versus the US dollar
Derivatives related to debt/liquid assets	(50)
Derivatives related to transactions	(1)
Total	(51)

The derivatives related to transactions can be further split into hedges of accounts receivable/payable and forecasted sales and purchases. These forecasted transactions are not financial instruments and therefore are not recorded in the accounts of the Company. The hedges related to these forecasted transactions are recorded as cash flow hedges. The results from such hedges are deferred in equity and amounted to a profit of EUR 18 million. This profit will be released to the income statement in 2003 when the related hedged transactions affect the income statement.

Virtually all transaction hedges that were outstanding at December 31, 2002 were forward foreign exchange contracts that will expire in 2003. During 2002 no results were recorded in the income statement as a result of ineffectiveness of these hedges.

Changes in fair value of hedges related to accounts payable, receivable, external debt and intercompany loans are recognized in the income statement. The changes in fair value of these hedges are to a large extent offset by changes in fair value of the hedged items in the income statement. All hedges related to debt and liquid assets are forward exchange contracts or cross currency basis swaps.

Interest rate risk

At year-end 2002, Philips had a ratio of fixed-rate debt to total outstanding debt of approximately 73%, compared to 69% one year earlier. The Company partially hedges the interest rate risk inherent in the external debt. As of year-end 2002, the Company hedged a notional amount of EUR 300 million compared to outstanding EUR -denominated fixed-rate public debt of EUR 5,103 million.

The Company also entered into three interest rate swaps, paying fixed interest on EUR 50 million and receiving fixed interest on EUR 14 million for general asset and liability management purposes. The results on these interest rate swaps are recognized in the income statement.
Interest rate swaps hedge the Company against adverse movements of long-term interest rates. The interest rate hedges related to bonds are fair value hedges; thus profits resulting from the hedges (EUR 7 million in 2002) are offset by equal and opposite losses recorded on the underlying financial instruments in the income statement. Some interest rate hedges related to bonds were unwound during 2002. The fair value adjustments to the bonds will be amortized to the income statement based on the recalculated effective yield. In 2003 we expect to release a gain of EUR 14 million. As the fixed flows of the swaps match exactly the coupons of the underlying financial instruments, the hedges have been effective. No results were released to the income statement as a result of ineffectiveness of interest rate hedges in 2002.

As of December 31, 2002 the majority of debt consisted of bonds. Of the EUR 6,118 million of outstanding bonds, 4% have a so-called 'embedded put' feature, which allows the investor to ask for redemption of the bonds in one specific month prior to their final maturity date.

A sensitivity analysis shows that if long-term interest rates were to decrease instantaneously by 1% from their level of December 31, 2002, with all other variables (including foreign exchange rates) held constant, the fair value of the long-term debt would increase by EUR 273 million. The fair value of long-term debt plus the fair value of related interest rate swaps would increase by EUR 265 million (compared to EUR 267 million in 2001). This increase is based on the assumption that the 'putable' bonds will be repaid at their final maturity date. If the bondholders required payment at their respective put dates and there was an increase in interest rates by 1%, this would reduce the market value of the long-term debt by EUR 249 million. In this case, the fair value of long-term debt plus the fair value related to interest rate swaps would decrease by EUR 241 million (compared to EUR 221 million in 2001).

If interest rates were to increase instantaneously by 1% from their level of December 31, 2002, with all other variables held constant, the interest expense would increase by EUR 4 million in 2003.

Other financial risks

Other financial risks include the equity price risk, commodity price risk, credit risk and country risk.
The rating of the Company's debt by major rating services may improve or deteriorate. As a result, the Company's borrowing capacity may be influenced and its financing costs may fluctuate.

Equity price risk

In 2002, an impairment loss of EUR 1,955 million was recognized on the security investments in Vivendi Universal, GN Great Nordic and JDS Uniphase in view of the extended period of time during which the market value of these shares was below cost.
In addition to Vivendi, GN Great Nordic and JDS Uniphase, Philips is a shareholder of other publicly listed companies such as TSMC, Atos Origin, ASML, FEI and MedQuist and therefore is exposed to the equity price risk through movements in the share prices of these companies. The aggregate market value of all these equity investments amounted to EUR 6,798 million at year-end 2002 (2001: EUR 16,201 million).

In November 2000, Philips purchased 1.3 billion redeemable preferred shares in Taiwan Semiconductor Manufacturing Company (a publicly listed Taiwanese company in which the Philips Group has a substantial shareholding) for 12,999 million Taiwanese dollars (at closing rate December 31, 2002; EUR 374 million). The preferred shares are redeemable in the second quarter of 2003.

The dividend yield on these preferred shares is 3.5%. The preferred shares confer the same voting rights as TSMC's common shares. The preferred shares are carried at cost in the accompanying consolidated balance sheet. The redeemable preferred shares result in a concentration of credit risks. However, the Company is of the opinion that TSMC will have sufficient means to redeem the preferred shares at the redemption date.

Commodity price risk

The Company is a purchaser of certain base metals (such as copper), precious metals and energy. The Company hedges certain commodity price risks using derivative instruments to minimize significant, unanticipated earnings fluctuations caused by commodity price volatility. The commodity price derivatives that the Company enters into are concluded as cash flow hedges to offset forecasted purchases.

Credit risks

The Company invests available cash and cash equivalents with various financial institutions. The Company is also exposed to credit risks in the event of non-performance by counterparties with respect to derivative financial instruments.
The Company measures on a daily basis the potential loss, should a financial counterparty default. These worst-case scenario losses are monitored and limited by the Company. As of December 31, 2002 the Company had credit risk of over 25 million euro to

1 AAA/ Aaa-rated bank counterparties
6 AA/ Aa-rated bank counterparties
2 A/ A-rated bank counterparties
2 lower-rated bank counterparties in China.

The Company does not enter into any derivative financial instruments to protect against default of financial counterparties. However, the Company requires all financial counterparties with whom it deals in derivative transactions to complete legally enforceable set-off agreements prior to trading and, whenever possible, to have a strong credit rating from Standard & Poor's and Moody's Investor Services. It is the Company's policy to conclude financial transactions, where possible, under an ISDA (International Swap Dealers Association) master agreement. Wherever possible, cash is invested and financial transactions are concluded with financial institutions with strong credit ratings.

Credit risk represents the loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. As of December 31, 2002, the Company identified 4 customers with significant outstanding receivables. This exposure amounts to EUR 247 million in total and ranges from EUR 53 million to EUR 72 million per customer. To reduce exposure to credit risk, the Company performs ongoing credit evaluations of the financial condition of its customers and adjusts payment terms when appropriate.

Country risk

The Company is exposed to country risk by the very nature of running a global business. The country risk per country is defined as the sum of equity of all subsidiaries and associated companies in country cross-border transactions such as intercompany loans, guarantees (unless country risk is explicitly excluded in the guarantee), accounts receivables and intercompany accounts. The country risk is monitored on a regular basis.

As of December 31, 2002 the Company had country risk exceeding EUR 500 million in each of the following countries:
the Netherlands, Germany, France, Belgium, USA, Taiwan and Korea. At year-end exposure to Argentina was less than EUR 50 million and exposure to Venezuela less than EUR 20 million.

The degree of risk of a country is taken into account when new investments are considered. The Company does not, however, enter into derivative financial instruments to hedge country risk.

Other insurable risks

The Philips Group is covered for financial losses by global insurance policies.
To reduce risks, Philips has a worldwide property damage and business interruption loss prevention program in place.
Factories are inspected on a regular basis against predefined risk engineering standards.
Status information on the existing prevention levels is monitored centrally and presented to financial/industrial product division management.
Inconsistencies with these standards are reported to product division management, and budgets are made available for further improvement of the loss-prevention levels.

Fair value of financial assets and liabilities

The estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methods. The estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market exchange or the value that will ultimately be realized by the Company upon maturity or disposal. Additionally, because of the variety of valuation techniques permitted under SFAS No. 107, 'Disclosures about Fair Value of Financial Instruments', comparisons of fair values between entities may not be meaningful. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts.

	December 31, 2002		December 31, 2001	
	carrying amount	estimated fair value	carrying amount	estimated fair value
Assets:				
Cash and cash equivalents	**1,858**	**1,858**	890	890
Accounts receivable – current	**5,068**	**5,068**	5,812	5,812
Other financial assets	**1,306**	**1,306**	3,481	3,481
Accounts receivable – non-current	**219**	**195**	306	272
Derivative instruments	**176**	**176**	237	237
Liabilities:				
Accounts payable	**(3,228)**	**(3,228)**	(3,243)	(3,243)
Debt	**(7,109)**	**(7,443)**	(7,866)	(7,945)

The following methods and assumptions were used to estimate the fair value of financial instruments:

Cash, accounts receivable and accounts payable

The carrying amounts approximate fair value because of the short maturity of these instruments.

Cash equivalents
The fair value is based on the estimated market value.

Other financial assets
For other financial assets, fair value is based upon the estimated market prices.

Debt
The fair value is estimated on the basis of the quoted market prices for certain issues, or on the basis of discounted cash flow analyses based upon Philips' incremental borrowing rates for similar types of borrowing arrangements with comparable terms and maturities.

31 Information relating to product sectors and main countries
Philips has made significant progress in strategic refocusing of its portfolio of businesses. At present, rather than acquiring businesses in new areas, Philips is focusing on strengthening its existing core activities, including the use of selected acquisitions, and the disposal of activities that are under-performing or not essential from a strategic viewpoint.
Philips' internal organization and internal reporting structure is organized in compliance with SFAS No. 131. As a result, the following 8 product sectors are distinguished as reportable segments: Lighting, Consumer Electronics, Domestic Appliances and Personal Care, Components, Semiconductors, Medical Systems, Miscellaneous and Unallocated.
On October 9, 2002 it was announced that the Components division will be dissolved as from 2003. Part of the division's activities will be moved to Semiconductors (Mobile Display Systems and the telecom speakers activity). Another part will be moved to Consumer Electronics (LCD TV, multimedia projectors, LCoS TV, wireless connectivity modules and parts of remote control systems). The Optical Storage business will be restructured and transferred to the Miscellaneous sector. The remaining activities will be transferred to the Corporate Investments group (in the Miscellaneous sector) for potential sale or merger.
Furthermore, the activities belonging to Digital Networks will be relocated within the Consumer Electronics sector and partly to the Miscellaneous sector from 2003 onwards.

Lighting
Philips is the leader in the world lighting market. A wide variety of applications are served by a full range of incandescent and halogen lamps, automotive lamps, high-intensity gas-discharge and special lamps, QL induction lamps, fixtures, ballasts and lighting electronics. Philips Lighting, along with LumiLeds Lighting, the joint venture with Agilent Technologies, is spearheading the development of new application segments for the latest LED technology, both in the home and in the wider outside environment.

Consumer Electronics
This division markets a wide range of products in the following areas: video products (Consumer TV, VCR, TV-VCR, DVD Video and DVD+RW), audio products (audio systems, portable products), computer monitors (CRT- and LCD-based), consumer communications (mobile phones, cordless digital phones) and set-top boxes.

Domestic Appliances and Personal Care
This division markets a wide range of products in the following areas: male shaving and grooming (shavers, trimmers, etc.), beauty, health and suncare (depilators, hair dryers, suncare, skincare, etc.), oral healthcare (electric toothbrushes), food and beverage (mixers, coffee makers, toasters, etc.) and home environment care (vacuum cleaners, air cleaners, steam irons, fans, etc.).

Components

Until year-end 2002 Philips Components was a major provider of integrated digital electronic solutions in the areas of displays, storage and connectivity. Its global customer base covered the computing, consumer electronics, telecommunications and automotive industries. It produced modules for optical storage in CD and DVD formats and mobile display systems for use in cellular phones and other handheld devices. It also produced wireless connectivity modules to address the digital, Internet-driven, 24/7 world. It also encompassed speaker systems, multimedia projectors and digital display systems (LCoS panels, LCD TV, etc).

Semiconductors

Philips Semiconductors is a major supplier of integrated circuits (ICs) and discrete semiconductors to the consumer electronics, telecommunications, automotive, PC and PC peripherals industries.

Medical Systems

Philips Medical Systems is one of the world's leading suppliers of medical imaging modalities and patient monitoring systems. It is a global leader in the product segments X-ray, ultrasound, nuclear medicine and patient monitoring. It holds also strong positions in magnetic resonance, computed tomography medical IT and customer support services.

Miscellaneous

This sector comprises various activities and businesses not belonging to a product sector. It consists mainly of two groups of activities: the central research and technology centers (such as Philips Research, Intellectual Property and Standards, Philips Centre for Industrial Technology and Philips Design) and Corporate Investments (such as Assembléon and Philips Enabling Technologies Group (PETG)). It also comprises various (remaining) activities that have been sold, discontinued, phased out or deconsolidated in earlier years. NavTech was consolidated for the first time in 2001 and included in the Miscellaneous sector. Until its deconsolidation in May 2001 FEI Company was included in the consolidated figures of the Miscellaneous sector. Also included are some remaining former businesses from the Consumer Electronics and Components sectors and the equity investment in Atos Origin.

Unallocated

The sector Unallocated includes general and administrative expenses in the corporate center and the regional and country organizations.
The sales volumes of the various business activities and the associated income from operations by product sector and by geographic area are set forth in the following tables. Segment revenues represent the total of sales to third parties ('sales') and sales of products and services between the product sectors ('intersegment revenues').
Included in segment revenues by geographic area is the total revenue from worldwide sales to third parties and unconsolidated companies by consolidated companies located within that geographic area ('sales'), as well as the total value of sales to consolidated companies in other geographic areas ('interregional revenues'). The transfer prices charged for all intersegment (including interregional) sales are based on the arm's length principle as set forth in internationally accepted transfer pricing policies and guidelines.

Origin

Origin is a global IT service company delivering systems and a full range of services that facilitate total business solutions for clients. It is represented in more than 30 countries. In October 2000, Philips sold its 98% interest in Origin to Atos and received a 48.7% interest in Atos Origin. This investment is accounted for under the equity method. As a result of the merger, as from October 1, 2001 Philips no longer consolidates Origin as a separate division but includes its share of Atos Origin's earnings in results relating to unconsolidated companies beginning January 1, 2001, with a delay of three months.

Product sectors

2002

	sales (to third parties)	segment revenues	income (loss) from operations	as a % of segment revenues	results relating to unconsolidated companies
Lighting	4,845	4,873	602	12.4	(23)
Consumer Electronics	9,600	9,669	230	2.4	(23)
DAP	2,273	2,294	401	17.5	–
Components	2,212	2,450	(329)	(13.4)	(386)
Semiconductors	4,089	4,613	(537)	(11.6)	75
Medical Systems	6,844	6,855	309	4.5	(44)
Miscellaneous	1,957	2,399	74	3.1	(946)
Unallocated	–	–	(330)		1
Total	**31,820**	**33,153**	**420**		**(1,346)**
Intersegment revenues		**(1,333)**			
Sales		**31,820**			
Income from operations as a % of sales			**1.3**		

2001

	sales (to third parties)	segment revenues	income (loss) from operations	as a % of segment revenues	results relating to unconsolidated companies
Lighting	5,083	5,122	582	11.4	(13)
Consumer Electronics	11,052	11,233	(649)	(5.8)	–
DAP	2,224	2,246	334	14.9	–
Components	2,772	3,705	(667)	(18.0)	(395)
Semiconductors	4,389	4,940	(607)	(12.3)	(118)
Medical Systems	4,834	4,836	(163)	(3.4)	1
Miscellaneous	1,985	2,154	(104)	(4.8)	(79)
Unallocated	–	–	(121)		(4)
Total	32,339	34,236	(1,395)		(608)
Intersegment revenues		(1,897)			
Sales		32,339			
Income from operations as a % of sales			(4.3)		

2000

	sales (to third parties)	segment revenues	income (loss) from operations	as a % of segment revenues	results relating to unconsolidated companies
Lighting	5,052	5,097	668	13.1	(33)
Consumer Electronics	13,060	13,277	410	3.1	(4)
DAP	2,107	2,130	287	13.5	–
Components	5,042	6,920	608	8.8	211
Semiconductors	5,879	6,812	1,346	19.8	1,137
Medical Systems	3,031	3,047	169	5.5	(3)
Miscellaneous	2,974	3,378	(191)	(5.7)	2,647
Unallocated	–	–	(102)		3
Origin	717	1,164	1,063	91.3	(2)
Total	37,862	41,825	4,258		3,956
Intersegment revenues		(3,963)			
Sales		37,862			
Income from operations as a % of sales			11.2		

Product sectors

2002

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation
Lighting	2,608	1,723	866	1,290	183	180
Consumer Electronics	2,553	28	2,489	317	99	160
DAP	961	529	432	501	83	89
Components	3,799	118	759	330	87	152
Semiconductors	6,898	3,606	892	3,441	441	954
Medical Systems	6,780	4,849	1,886	4,199	85	84
Miscellaneous	1,862	(73)	1,296	656	130	125
Unallocated	6,828	(241)	2,462	337	53	38
Total	**32,289**	**10,539**	**11,082**	**11,071**	**1,161**	**1,782**

2001

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation
Lighting	2,936	1,979	929	1,473	224	179
Consumer Electronics	3,429	672	2,660	551	202	265
DAP	1,084	652	432	571	105	81
Components	4,193	397	730	485	475	267
Semiconductors	8,329	4,742	927	4,431	956	943
Medical Systems	7,962	5,418	2,471	4,880	86	75
Miscellaneous	2,734	314	837	427	95	86
Unallocated	8,535	135	2,988	421	–	73
Total	39,202	14,309	11,974	13,239	2,143	1,969

2000

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation
Lighting	2,944	1,903	947	1,367	258	171
Consumer Electronics	4,643	1,486	3,092	644	335	195
DAP	1,131	752	379	564	96	77
Components	5,740	2,158	1,499	2,157	639	332
Semiconductors	8,497	4,572	1,283	4,233	1,631	692
Medical Systems	3,982	2,821	1,157	2,429	58	47
Miscellaneous	3,361	819	1,057	531	153	231
Unallocated	9,226	(141)	2,907	406	–	44
Total	39,524	14,370	12,321	12,331	3,170	1,789

Goodwill assigned to product sectors

2002

	carrying value at January 1	acquisitions	goodwill amortization related to sale of business	impairment	translation differences and other changes	carrying value at December 31
Lighting	116				(30)	86
Consumer Electronics	5				(1)	4
DAP	166				(25)	141
Semiconductors	217	37			(26)	228
Medical Systems	3,019	31		(19)	(339)	2,692
Miscellaneous	3				(3)	–
Unallocated	31	12			(2)	41
Total	**3,557**	**80**	**–**	**(19)**	**(426)**	**3,192**

Main countries

2002	sales (to third parties)	total assets	net operating capital	long-lived assets	capital expenditures	depreciation
Netherlands	1,507	5,694	2,724	1,596	238	345
United States	9,409	9,259	5,303	5,633	127	544
Germany	2,333	1,670	303	664	115	109
France	1,893	2,194	32	426	214	110
United Kingdom	1,503	629	251	293	18	32
China	2,510	1,311	(323)	378	112	157
Other countries	12,665	11,532	2,249	2,081	337	485
Total	**31,820**	**32,289**	**10,539**	**11,071**	**1,161**	**1,782**

2001	sales (to third parties)	total assets	net operating capital	long-lived assets	capital expenditures	depreciation
Netherlands	1,555	5,818	2,799	1,767	403	333
United States	8,901	10,640	6,902	6,838	386	516
Germany	2,648	1,831	508	711	226	123
France	1,990	4,794	85	377	157	182
United Kingdom	1,560	752	448	210	46	48
China	2,205	1,428	213	523	224	171
Other countries	13,480	13,939	3,354	2,813	701	596
Total	32,339	39,202	14,309	13,239	2,143	1,969

2000	sales (to third parties)	total assets	net operating capital	long-lived assets	capital expenditures	depreciation
Netherlands	1,696	9,555	2,932	1,885	638	369
United States	9,126	8,802	5,820	5,051	573	349
Germany	3,272	1,644	128	672	194	132
France	2,333	2,749	222	474	205	120
United Kingdom	2,179	951	526	337	89	61
China	2,683	2,113	783	814	295	156
Other countries	16,573	13,710	3,959	3,098	1,176	602
Total	37,862	39,524	14,370	12,331	3,170	1,789

Dutch GAAP information

Accounting principles applied for Dutch GAAP purposes

The financial statements of Koninklijke Philips Electronics N.V. and the consolidated financial statements that are included in this section are prepared on a basis consistent with generally accepted accounting principles in the Netherlands ('Dutch GAAP').
These accounting principles are largely in conformity with the accounting policies that are applied in the Company's primary consolidated financial statements as prepared under United States Generally Accepted Accounting Principles ('US GAAP '). The reader is referred to these accounting policies on pages 49 through 57 of this report.
The notes to the consolidated financial statements as prepared under US GAAP are an integral part of the financial statements as prepared under Dutch regulations in this section. Material differences based on deviations between US GAAP and Dutch GAAP are disclosed separately in this section.
Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is amortized on a straight-line basis over the expected periods to be benefited, not exceeding 20 years under Dutch GAAP. The Company assesses the recoverability by determining whether the unamortized balance of goodwill can be recovered from future operating cash flows of the acquired operation. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows using a business-specific Weighted Average Cost of Capital.

Presentation of financial statements

The balance sheet presentation in the Dutch GAAP section is different from the one used under Dutch regulations and is more in line with common practice in the United States in order to achieve optimal transparency for Dutch and US shareholders.
Under this format, the order of presentation of assets and liabilities is based on the degree of liquidity which is common practice in the United States.

Changes in accounting principles and presentation

As of January 1, 2002 the Company adopted US GAAP as accounting principles for its primary accounts. Changes have been made to the Dutch GAAP accounting principles and presentation applied by the Company as from January 1, 2002, for which the primary reason is harmonization to US GAAP.
Securities that are designated as available-for-sale are classified under other non-current financial assets and are stated at their fair values. Changes in the fair values are recognized in the revaluation reserve within stockholders' equity. Other-than-temporary declines in the fair value below cost price are charged to financial income and expenses.
Gains or losses resulting from sale and operational lease-back transactions are deferred over the term of the lease in proportion to the rental payments.
For comparability reasons, the previous-year statements have been restated for this effect, with recognition of the effect in stockholders' equity as of the beginning of the year 2000.

Application of Generally Accepted Accounting Principles in the Netherlands

The accounting principles applied in the preparation of the US GAAP consolidated financial statements differ in some respects from those generally accepted in the Netherlands.

For the determination of net income and stockholders' equity in accordance with generally accepted accounting principles in the Netherlands (Dutch GAAP), the following difference with US GAAP has been taken into account:

Under US GAAP, SFAS No. 142, goodwill is no longer amortized but tested for impairment on an annual basis and whenever indicators of impairment arise. Under Dutch GAAP, goodwill is amortized on a straight-line basis not exceeding 20 years.
As a consequence, impairment charges under Dutch GAAP may be different from US GAAP.

Reconciliation of net income according to Dutch GAAP versus US GAAP

	2002	2001
Net income (loss) as per the consolidated statements of income on a US GAAP basis	(3,206)	(2,475)
Adjustments to Dutch GAAP:		
Goodwill amortization net of taxes	(743)	(133)
Lower impairment charges due to amortization of goodwill	347	–
Net income (loss) in accordance with Dutch GAAP	(3,602)	(2,608)
Basic earnings per common share in EUR:		
Net income (loss)	(2.83)	(2.04)
Diluted earnings per common share in EUR:		
Net income (loss)	(2.83)	(2.04)

Reconciliation of stockholders' equity according to Dutch GAAP versus US GAAP

	2002	2001
Stockholders' equity as per the consolidated balance sheets on a US GAAP basis	13,919	19,160
Equity adjustments that affect net income:		
Goodwill amortization net of taxes	(876)	(133)
Lower impairment charges due to amortization of goodwill	347	–
Equity adjustments not affecting net income under Dutch GAAP:		
Translation differences	17	–
Stockholders' equity in accordance with Dutch GAAP	13,407	19,027

Consolidated statements of income of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

Note			2002		2001*
	Sales		31,820		32,339
	Cost of sales		(22,209)		(23,276)
	Gross margin		9,611		9,063
	Selling expenses	(5,017)		(5,027)	
	General and administrative expenses	(1,404)		(1,249)	
	Research and development expenses	(3,043)		(3,312)	
	Write-off of acquired in-process R&D	(12)		(106)	
	Impairment of goodwill	(19)		–	
	Restructuring and impairment charges	(484)		(786)	
			(9,979)		(10,480)
	Other business income (expense)		485		(14)
32	**Income (loss) from operations**		117		(1,431)
3	Financial income and expenses:				
	- interest	(384)		(391)	
	- impairment charges	(1,955)		(526)	
	- other	112		2	
			(2,227)		(915)
	Income (loss) before taxes		(2,110)		(2,346)
33	Income taxes benefits		7		441
	Income (loss) after taxes		(2,103)		(1,905)
34	Results relating to unconsolidated companies:				
	- income (loss) excluding impairment charges and amortization of goodwill	(17)		(232)	
	- impairment charges	(958)		(119)	
	- amortization of goodwill	(498)		(367)	
			(1,473)		(718)
	Group income (loss)		(3,576)		(2,623)
6	Minority interests		(26)		15
	Net income (loss)		(3,602)		(2,608)

* Restated

The accompanying notes are an integral part of these consolidated financial statements.

Earnings per share

	2002	2001*
Weighted average number of common shares outstanding (after deduction of treasury stock) during the year (in thousands)	**1,274,950**	1,278,077
Basic earnings per common share in euros:		
Net income (loss)	**(2.83)**	(2.04)
Diluted earnings per common share in euros: **		
Net income (loss)	**(2.83)**	(2.04)
Dividend paid per common share in euros (related to prior financial year)	**0.36**	0.36

* Restated

** The dilution effects on EPS are only taken into consideration if this does not result in an improvement in income per share or in a reduction in loss per share, as is the case in 2002 and 2001.

Consolidated balance sheets of the Philips Group as of December 31

in millions of euros unless otherwise stated

The consolidated balance sheets are presented before appropriation of profit

Assets

Note			2002		2001*
	Current assets				
	Cash and cash equivalents		1,858		890
9	Receivables:				
	- Accounts receivable – net	4,517		5,298	
	- Accounts receivable from unconsolidated companies	63		122	
	- Other receivables	488		392	
			5,068		5,812
10	Inventories		3,522		4,290
11	Other current assets		603		858
	Total current assets		11,051		11,850
	Non-current assets				
34	Unconsolidated companies:				
	- Goodwill	1,584		1,784	
	- Equity investments	3,873		5,196	
	- Loans	395		462	
			5,852		7,442
12	Other non-current financial assets		1,306		3,481
13	Non-current receivables:				
	- Accounts receivable – net	123		149	
	- Accounts receivable from unconsolidated companies	–		1	
	- Other receivables	96		156	
			219		306
35	Other non-current assets		2,600		2,787
15	Property, plant and equipment:				
	- At cost	16,015		18,069	
	- Less accumulated depreciation	(9,878)		(10,351)	
			6,137		7,718
16	Intangible assets excluding goodwill:				
	- At cost	2,529		2,585	
	- Less accumulated amortization	(787)		(621)	
			1,742		1,964
36	Goodwill consolidated companies:				
	- At cost	3,602		3,978	
	- Less accumulated amortization	(732)		(457)	
			2,870		3,521
	Total non-current assets		20,726		27,219
	Total		31,777		39,069

* Restated

The accompanying notes are an integral part of these consolidated financial statements.

Liabilities and stockholders' equity

Note			2002		2001*
	Current liabilities				
	Accounts and notes payable:				
	- Trade creditors	3,138		3,240	
	- Unconsolidated companies	90		3	
			3,228		3,243
18	Accrued liabilities		3,314		3,966
19 20	Short-term provisions		1,276		1,443
21	Other current liabilities		691		813
22 23	Short-term debt		617		1,271
	Total current liabilities		9,126		10,736
	Non-current liabilities				
22 23	Long-term debt		6,492		6,595
19 20	Long-term provisions		1,970		2,297
24	Other non-current liabilities		603		212
	Total non-current liabilities		9,065		9,104
25	Commitments and contingent liabilities		–		–
	Group equity				
6	Minority interests		179		202
37	Stockholders' equity:				
	Common shares, par value EUR 0.20 per share:				
	Authorized: 3,250,000,000 shares				
	Issued: 1,316,070,392 shares				
	(1,316,070,392 shares in 2001)	263		263	
	Share premium	14		13	
	Other reserves	17,774		22,087	
	Revaluation reserves	265		566	
	Net income (loss)	(3,602)		(2,608)	
	Treasury shares, at cost: 40,092,469 shares				
	(41,897,949 in 2001)	(1,307)		(1,294)	
			13,407		19,027
	Total		31,777		39,069

* Restated

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statements of changes in stockholders' equity of the Philips Group

in millions of euros unless otherwise stated

	number of shares outstanding	number of shares issued	issued, paid-up capital	share premium	other reserves	revaluation reserve	treasury shares	total
Balance as of December 31, 2000	1,283,894,733	1,316,070,392	263	7	22,427	–	(961)	21,736
Changes in accounting policies					(1)	972		971
Net income (loss)					(2,608)			(2,608)
Net current period change						(406)		(406)
Dividend paid					(458)			(458)
Stock options accrual				6				6
Minimum pension liability					(5)			(5)
Treasury stock transactions							(333)	(333)
Translation differences and other changes					124			124
Balance as of December 31, 2001	1,274,172,443	1,316,070,392	263	13	19,479	566	(1,294)	19,027
Net income (loss)					(3,602)			(3,602)
Net current period change						(301)		(301)
Dividend paid					(459)			(459)
Stock options accrual				1				1
Minimum pension liability					(335)			(335)
Treasury stock transactions							(13)	(13)
Translation differences and other changes					(911)			(911)
Balance as of December 31, 2002	**1,275,977,923**	**1,316,070,392**	**263**	**14**	**14,172**	**265**	**(1,307)**	**13,407**

Notes to the consolidated financial statements of the Philips Group

all amounts in millions of euros unless otherwise stated

The reader is referred to the notes to the consolidated financial statements based on US GAAP. The differences between Dutch GAAP and US GAAP are disclosed in the notes below.

32 Income from operations

See note 2 to the consolidated financial statements based on US GAAP.

Depreciation and amortization

The difference of EUR 303 million in 2002 (2001: EUR 36 million) in depreciation and amortization between Dutch and US GAAP is caused by the fact that goodwill is no longer amortized under US GAAP for acquisitions after June 30, 2001 and completely ceased to apply as from January 1, 2002.

Depreciation of property, plant and equipment and amortization of intangibles are as follows:

	2002	2001
Depreciation of property, plant and equipment	**1,814**	1,994
Amortization of software	**174**	146
Amortization of goodwill and other intangibles:		
- Amortization of other intangible assets	**165**	155
- Amortization of goodwill relating to consolidated companies	**303**	216
- Impairment of goodwill	**19**	–
Write-off of in-process R&D	**12**	106
	2,487	2,617

Amortization of goodwill relating to consolidated companies and other intangible assets increased because of full-year amortization of acquisitions in 2001.

33 Income taxes

See note 4 to the consolidated financial statements based on US GAAP.

The difference in income taxes based on Dutch GAAP and income taxes based on US GAAP relates to the different accounting treatment under Dutch GAAP of amortization of tax-deductible goodwill, which is charged to income under Dutch GAAP and no longer recognized under US GAAP.
The effect for 2002 is a tax benefit of EUR 34 million (2001: EUR 13 million).

34 Unconsolidated companies

See note 5 to the consolidated financial statements based on US GAAP.

Results relating to unconsolidated companies

The difference of EUR 127 million in 2002 (2001: EUR 110 million) in results relating to unconsolidated companies between Dutch and US GAAP is caused by the fact that goodwill is no longer amortized under US GAAP for acquisitions after June 30, 2001 and completely ceased to apply as from January 1, 2002.
As the results related to Atos Origin are reported on a three-month delay basis, amortization of goodwill of EUR 24 million referring to the fourth quarter of 2001 was included in the year 2002 results for both US and Dutch GAAP.

	2002	2001
Results relating to unconsolidated companies:		
- income (loss) excluding amortization of goodwill and impairment charges	**(17)**	(232)
- impairment charges	**(958)**	(119)
- amortization of goodwill	**(498)**	(367)
Total	**(1,473)**	(718)

For the Company's investment in two unconsolidated companies, LG.Philips Displays and Atos Origin, impairment charges were recognized in the US GAAP accounts. For Dutch GAAP the related impairment charge is reduced by the goodwill amortization recognized in the course of the year and in previous periods amounting to EUR 275 million and EUR 72 million respectively.

Amortization of goodwill includes the amortization of the excess of the Company's investment over its underlying equity in the net assets of unconsolidated companies of EUR 458 million in 2002 (2001: EUR 180 million) and the Company's share of amortization recorded by the unconsolidated companies of EUR 40 million in 2002 (2001: EUR 187 million).

Amortization of goodwill in 2002 amounting to EUR 197 million was substantially higher than the previous year because of full-year amortization of goodwill related to LG.Philips Displays (2001: EUR 90 million).

Investments in, and loans to, unconsolidated companies

Investments in, and loans to, unconsolidated companies amounted to EUR 5,457 million and EUR 395 million respectively at December 31, 2002 (2001: EUR 6,980 million and EUR 462 million respectively).

The difference in 2002 between Dutch and US GAAP in investments in unconsolidated companies of EUR 237 million (2001: EUR 110 million) results from the accumulated effect of amortization of goodwill under Dutch GAAP.

Goodwill relating to unconsolidated companies

	goodwill relating to unconsolidated companies
Balance as of January 1, 2002:	
Acquisition cost	2,095
Accumulated amortization	(311)
Book value	1,784
Changes in book value:	
Acquisitions	162
Amortization and write-downs	(362)
Total changes	(200)
Balance as of December 31, 2002:	
Acquisition cost	2,257
Accumulated amortization	(673)
Book value	**1,584**

35 Other non-current assets

See note 14 to the consolidated financial statements based on US GAAP.

The difference in other non-current assets between Dutch and US GAAP in 2002 of EUR 47 million (2001: EUR 13 million) results from the tax effect on the amortization of tax-deductible goodwill under Dutch GAAP.

36 Goodwill – consolidated companies

See note 17 to the consolidated financial statements based on US GAAP.

The difference in 2002 between Dutch and US GAAP of EUR 322 million (2001: EUR 36 million) results from the accumulated effect of amortization of goodwill under Dutch GAAP.

	goodwill relating to consolidated companies
Balance as of January 1, 2002:	
Acquisition cost	3,978
Accumulated amortization	(457)
Book value	3,521
Changes in book value:	
Reclassifications	(16)
Acquisitions	80
Amortization and write-downs	(303)
Impairment losses	(19)
Translation differences	(392)
Changes in consolidation	(1)
Total changes	(651)
Balance as of December 31, 2002:	
Acquisition cost	3,602
Accumulated amortization	(732)
Book value	**2,870**

37 Stockholders' equity

As of January 1, 2002 the opening balance of stockholders' equity was adjusted in connection with the change in accounting principles as referred to on page 110. Stockholders' equity determined in accordance with Dutch GAAP amounted to EUR 13,407 million as of December 31, 2002 (2001: EUR 19,027 million), compared to EUR 13,919 million (2001: EUR 19,160 million) under US GAAP. The deviation is caused by the fact that for both years 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.

Balance sheets and statements of income of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics')

in millions of euros

* Restated

The balance sheets are presented before appropriation of profit

Balance sheets as of December 31

		2002			2001*
	Assets				
	Current assets:				
	Cash and cash equivalents	1,114		25	
A	Receivables	3,338		2,186	
			4,452		2,211
	Non-current assets:				
B	Investments in affiliated companies	18,257		23,580	
C	Other non-current financial assets	952		3,112	
D	Tangible fixed assets – net	1		1	
E	Intangible assets – net	1,135		1,196	
			20,345		27,889
	Total		24,797		30,100
	Liabilities and stockholders' equity				
	Current liabilities:				
F	Other liabilities	468		364	
G	Short-term debt	4,489		4,109	
H	Short-term provisions	48		7	
			5,005		4,480
	Non-current liabilities:				
I	Long-term debt	6,364		6,368	
H	Long-term provisions	21		225	
			6,385		6,593
J	Stockholders' equity:				
	Priority shares, par value EUR 500 per share:				
	Authorized and issued: 10 shares				
	Preference shares, par value EUR 0.20 per share:				
	Authorized: 3,249,975,000 shares				
	Issued: none				
	Common shares, par value EUR 0.20 per share:				
	Authorized: 3,250,000,000 shares				
	Issued: 1,316,070,392 shares				
	(1,316,070,392 shares in 2001)	263		263	
	Share premium	14		13	
	Other reserves	17,774		22,087	
	Revaluation reserves	265		566	
	Net income (loss)	(3,602)		(2,608)	
	Treasury shares, at cost: 40,092,469 shares				
	(41,897,949 shares in 2001)	(1,307)		(1,294)	
			13,407		19,027
	Total		24,797		30,100

Statements of income

		2002	2001*
	Income (loss) after taxes from affiliated companies	(2,063)	(1,933)
	Other income after taxes	(1,539)	(675)
L	**Net income (loss)**	(3,602)	(2,608)

Notes to the financial statements of Royal Philips Electronics

all amounts in millions of euros unless otherwise stated

Introduction

The financial statements of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics'), the parent company of the Philips Group, are included in the consolidated statements of the Philips Group. Therefore the unconsolidated statements of income of Royal Philips Electronics only reflect the net after-tax income of affiliated companies and other income after taxes.

With respect to the accounting principles, see page 110 of the Dutch GAAP consolidated financial statements, which form part of these notes.

A Receivables

	2002	2001
Trade accounts receivable	199	250
Group companies	2,915	1,646
Unconsolidated companies	14	30
Other receivables	29	30
Advances and prepaid expenses	5	3
Deferred tax assets	81	283
Income tax receivable	7	10
Derivative instruments	88	(66)
Total	**3,338**	2,186

An amount of EUR 63 million included in receivables is due after one year (2001: EUR 185 million).

B Investments in affiliated companies

The investments in affiliated companies are included in the balance sheet based on either their net asset value in conformity with the aforementioned accounting principles of the consolidated financial statements or their purchase price. Moreover, goodwill is included for an amount of EUR 1,580 million (2001: EUR 1,781 million).
The amortization period of goodwill ranges between 5 and 15 years.

	total	investments	loans
Balance as of January 1, 2002	23,580	15,417	8,163
Changes:			
Acquisitions/additions	2,592	1,524	1,068
Sales/redemptions	(3,050)	(553)	(2,497)
After-tax income (loss) from affiliated companies:			
- Amortization of goodwill	(665)	(665)	–
- Impairment losses	(958)	(958)	–
- Remaining income (loss)	(440)	(440)	–
Dividends received	(805)	(805)	–
Translation differences/other changes	(1,997)	(1,047)	(950)
Balance as of December 31, 2002	**18,257**	**12,473**	**5,784**

A list of affiliated companies, prepared in accordance with the relevant legal requirements, is deposited at the Commercial Register in Eindhoven, the Netherlands.

C Other non-current financial assets

	total	security investments	other receivables
Balance as of January 1, 2002	3,112	3,088	24
Changes:			
Acquisitions/additions	113	113	–
Sales/redemptions	(18)	(5)	(13)
Value adjustments	(2,255)	(2,254)	(1)
Balance as of December 31, 2002	**952**	**942**	**10**

Included in other non-current financial assets are participations and securities that generate income unrelated to the normal business operations.

D Tangible fixed assets – net

Balance as of January 1, 2002:	1
Cost	–
Accumulated depreciation	–
Book value	1
Changes in book value:	
Capital expenditures	–
Retirements and sales	–
Depreciation and write-downs	–
Total changes	–
Balance as of December 31, 2002:	
Cost	1
Accumulated depreciation	–
Book value	**1**

Tangible fixed assets consist of fixed assets other than land and buildings.

E Intangible fixed assets – net

Balance as of January 1, 2002:	
Acquisition cost	1,334
Accumulated amortization	(138)
Book value	1,196
Changes in book value:	
Acquisitions	44
Amortization and write-downs	(105)
Total changes	(61)
Balance as of December 31, 2002:	
Acquisition cost	1,378
Accumulated amortization	(243)
Book value	**1,135**

The intangible fixed assets represent goodwill and other intangibles arising from acquisitions and expenditures for patents and trademarks. Acquisitions comprise various small investments.

The amortization period ranges between 5 and 15 years.

F Other liabilities

	2002	2001
Other short-term liabilities	97	65
Deferred income and accrued expenses	371	299
Total	**468**	364

G Short-term debt

Short-term debt includes outstanding commercial paper for an amount of EUR 10 million, the current portion of outstanding long-term debt amounting to EUR 145 million (2001: EUR 160 million), debt to other Group companies totaling EUR 4,305 million (2001: EUR 3,206 million) and institutional financing totaling EUR 29 million (2001: EUR 222 million).

H Provisions

	2002	2001
Pensions	18	19
Deferred tax liabilities	–	191
Other	51	22
Total	**69**	232
Of which long-term	21	225
Of which short-term	48	7

As almost all obligations in connection with pension plans have been covered by separate pension funds or third parties, the provision for pensions refers to additional payments which the Company intends to make in the future.

I Long-term debt

	range of interest rates	average rate of interest	amount outstanding	due in 2003	due after 2003	due after 2007	average remaining term (in years)	amount out-standing 2001
Convertible debentures	1.1	1.1	145	–	145	–	3.0	134
Other debentures	4.2-8.8	5.9	6,218	139	6,079	2,972	5.0	6,249
Intercompany financing	1.3-3.2	2.9	1,475	1,475	–	–	–	1,119
Other long-term debt	4.6-10.20	5.1	146	6	140	29	3.8	145
Total		**5.7**	**7,984**	**1,620**	**6,364**	**3,001**		**7,647**
Corresponding data previous year		5.5	7,647	1,279	6,368	3,090		

The following amounts of the long-term debt as of December 31, 2002 are due in the next five years:

2003	1,620
2004	2,371
2005	602
2006	319
2007	71
	4,983
Corresponding amount previous year	4,557

Included in convertible debentures are Philips personnel debentures, for which the reader is referred to the related note in the Group accounts.

J Stockholders' equity

See the Group financial statements and related notes under Dutch GAAP.

No legal reserve for undistributed income from affiliated companies is required on the basis of the 'collective method', taking into account dividend distributions by affiliated companies, the receipt of which can be effected without restrictions.

Priority shares

There are ten priority shares.
The issuance of shares or rights to shares, cancellation of shares, amendments to the Articles of Association and the liquidation of the Company need approval of the priority shareholders, who also make a binding recommendation for the appointment of members of the Board of Management and the Supervisory Board (see also page 131).

Preference shares

The 'Stichting Preferente Aandelen Philips' has been granted the right to acquire preference shares in the Company. Such right has not been exercised (see also page 131).

Option rights

The Company has granted stock options on shares of Royal Philips Electronics at original exercise prices equal to market prices of the shares at the date of grant (see note 28).

Treasury shares

Royal Philips Electronics' shares which have been repurchased and are held in treasury for delivery upon exercise of options and convertible personnel debentures are accounted for in stockholders' equity. Treasury shares are recorded at cost, representing the market price on the acquisition date.
In order to reduce potential dilution effects, a total of 3,128,353 shares were acquired during 2002 at an average market price of EUR 32.97 per share, totaling EUR 103 million, and a total of 4,933,833 shares were delivered at an average exercise price of EUR 18.11, totaling EUR 90 million.
A total of 40,092,469 shares were being held by Group companies at December 31, 2002 (2001: 41,897,949 shares), acquired at an aggregate cost of EUR 1,307 million.

Other reserves

A cash distribution of EUR 0.36 per common share will be proposed to the General Meeting of Shareholders, which will result in a reduction of other reserves by EUR 459 million.

L Net income

Net income in 2002 amounted to a loss of EUR 3,602 million (2001: a loss of EUR 2,608 million).
For the remuneration of past and present members of both the Board of Management and the Supervisory Board, please refer to note 29 of the consolidated financial statements.

M Employees

The number of persons employed by Royal Philips Electronics at year-end 2002 was 12 (2001: 13) and included the members of the Board of Management and most members of the Group Management Committee.

N Obligations not appearing in the balance sheet

General guarantees as defined in Book 2, Section 403 of the Netherlands Civil Code have been given by Royal Philips Electronics on behalf of several Group companies in the Netherlands. The liabilities of these companies to third parties and unconsolidated companies totaled EUR 1,172 million as of year-end 2002 (2001: EUR 1,309 million). Guarantees totaling EUR 621 million (2001: EUR 679 million) have also been given on behalf of other Group companies, and guarantees totaling EUR 667 million (2001: EUR 506 million) on behalf of unconsolidated companies and third parties.

February 7, 2003

The Supervisory Board

The Board of Management

Other information regarding Royal Philips Electronics

Auditors' Report

Introduction

We have audited the 2002 financial statements of Koninklijke Philips Electronics N.V. appearing on pages 110 through 126. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

We conducted our audit in accordance with auditing standards generally accepted in the Netherlands and the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and the results of its operations for the year then ended in accordance with accounting principles generally accepted in the Netherlands and comply with the financial reporting requirements included in Part 9, Book 2 of the Netherlands Civil Code.

Eindhoven, February 7, 2003
KPMG Accountants N.V.

Proposed distribution to shareholders of Royal Philips Electronics

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 from the other reserves (2001: a distribution was made of EUR 0.36 per common share). This will result in a reduction of other reserves of the Company by EUR 459 million.

Corporate governance of the Philips Group

General

Koninklijke Philips Electronics N.V. (the 'Company') is the parent company of the Philips Group. Its shares are listed on the stock market of Euronext Amsterdam, the New York Stock Exchange, the London Stock Exchange and several other stock exchanges.

The management of the Company is entrusted to the Board of Management under the supervision of the Supervisory Board. The activities of the Philips Group are organized in product divisions, which are responsible for the worldwide business policy. Philips has more than 150 production sites in 35 countries and sales and service outlets in some 150 countries. It delivers products, systems and services in the fields of lighting, consumer electronics and communications, domestic appliances and personal care, components, semiconductors and medical systems. The statutory seat of the Company is Eindhoven, the Netherlands, and the statutory list of all subsidiaries and affiliated companies, prepared in accordance with the relevant legal requirements (The Netherlands Civil Code, Book 2, Articles 379 and 414), forms part of the notes to the consolidated financial statements and is deposited at the office of the Commercial Register in Eindhoven, the Netherlands (file no. 1910).

In recent years the governance of the Company and the Philips Group has been improved, in particular in respect of the supervisory function, the rights of shareholders and transparency. These improvements were in response to developments in the international capital markets, such as the United States, where the Company's shares have been traded since 1962 and listed on the New York Stock Exchange since 1987. Philips also generally endorses the recommendations of the Committee of the Amsterdam Exchanges of October 1997 on best practices in corporate governance.

Board of Management and Supervisory Board

The Board of Management is *responsible for* the effective management of the business. It is required to keep the Supervisory Board informed of developments, to consult it on important matters and to submit certain important decisions to it for its prior approval. The Board of Management *consists of* at least three members (currently five), who are elected for an indefinite period by the General Meeting of Shareholders. *Individual data* on the members of the Board of Management are printed on page 56 of the separate booklet entitled 'Management Report'. The President is *appointed by* the General Meeting of Shareholders. Members of the Board of Management may be *suspended by* the Supervisory Board and the General Meeting of Shareholders and *dismissed by* the latter. The *remuneration of* the members of the Board of Management is determined by the Supervisory Board upon a proposal from the President and on the advice of the Remuneration Committee of the Supervisory Board.

The Supervisory Board is independent of the Board of Management and is *responsible for* supervising both the policies of the Board of Management and the general direction of the Group's business. It is also required to advise the Board of Management. The Supervisory Board *consists of* at least five members (currently six). They elect a Chairman, Vice-Chairman and Secretary from their midst. The Board has *three permanent committees*: an Audit Committee, a Remuneration Committee and a Corporate Governance and Nomination & Selection Committee. These committees advise the plenary Supervisory Board. The Supervisory Board has adopted *Rules of Procedure* to consolidate its own governance rules. The *profile* for the Supervisory Board's composition and *additional data* on the individual members are given on page 58 of the separate booklet entitled 'Management Report'. Members of the Supervisory Board are *appointed by* the General Meeting of Shareholders for fixed terms of four years, and may be re-elected for two additional four-year terms. In exceptional cases, however, the Supervisory Board and the Meeting of Priority Shareholders may deviate from this rule. Members of the Supervisory Board may be suspended or dismissed by the General Meeting of Shareholders. Their *remuneration* is fixed by the General Meeting of Shareholders.

The appointment of the members of the Board of Management and the Supervisory Board by the General Meeting of Shareholders is upon a *binding recommendation* from the Supervisory Board and the Meeting of Priority Shareholders. However, this binding recommendation may be overruled by a resolution of the General Meeting of Shareholders taken by a majority of at least 2/3 of the votes cast and representing more than half of the issued share capital.

Group Management Committee

The Group Management Committee *consists of* the members of the Board of Management, certain Chairmen of product divisions and certain key officers. Members other than members of the Board of Management are *appointed by* the Supervisory Board. The task of the Group Management Committee, the highest consultative body within Philips, is to ensure that business issues and practices are shared across the Company and to define and implement common policies.

General Meeting of Shareholders

A General Meeting of Shareholders is held at least once a year to discuss and resolve on the report of the Board of Management, the annual accounts with explanation and appendices, the report of the Supervisory Board, any proposal concerning dividends or other distributions, and any other matters proposed by the Supervisory Board, the Board of Management, the Meeting of Priority Shareholders or shareholders in accordance with the provisions of the Company's Articles of Association. This meeting is held in Eindhoven, Amsterdam, Rotterdam or The Hague no later than six months after the end of the financial year. Meetings are *convened by* public notice and mailed to registered shareholders. *Extraordinary General Meetings* may be convened by the Supervisory Board or the Board of Management if deemed necessary and must be held if the Meeting of Priority Shareholders or shareholders jointly representing at least 10% of the outstanding capital make a written request to that effect to the Supervisory Board and the Board of Management specifying in detail the business to be dealt with. The *agenda* of the General Meeting of Shareholders shall contain such business as may be placed thereon by the Board of Management, the Supervisory Board or the Meeting of Priority Shareholders. Requests from shareholders for items to be included on the agenda will be honored, provided that such requests are made to the Board of Management and the Supervisory Board by shareholders representing at least 1% of the Company's outstanding capital at least 60 days before a General Meeting of Shareholders and provided that the Board of Management and the Supervisory Board are of the opinion that such requests are not detrimental to the serious interests of Philips.

The *main powers* of the General Meeting of Shareholders are to appoint, suspend and dismiss members of the Board of Management and the Supervisory Board, to adopt the financial statements and to discharge the Board of Management and the Supervisory Board from responsibility for performing their respective duties for the previous financial year, to adopt amendments to the Articles of Association and proposals to dissolve or liquidate the Company, to issue shares or rights to shares, to restrict or pass pre-emptive rights of shareholders and to repurchase or cancel outstanding shares. Following common practice, the Company each year requests limited authorization to issue (rights to) shares, to pass pre-emptive rights and to repurchase shares.

Meeting of Priority Shareholders and the Dr. A.F. Philips-Stichting

There are *ten priority shares* held by the Dr. A.F. Philips-Stichting. The self-electing Board of the *Dr. A.F. Philips-Stichting* consists of the Chairman and the Vice-Chairman and Secretary of the Supervisory Board, certain other members of the Supervisory Board, and the President of the Company. At present, the Board consists of Messrs L.C. van Wachem, W. de Kleuver, J.M. Hessels, K.A.L.M. van Miert and G.J. Kleisterlee.
A *Meeting of Priority Shareholders* is held at least once a year, at least thirty days before the General Meeting of Shareholders. Approval of the Meeting of Priority Shareholders is required for resolutions of the General Meeting of Shareholders regarding the issue of shares or rights to shares, the cancellation of shares, amendments to the Articles of Association, and the liquidation of the Company. Acting in agreement with the Supervisory Board, the Meeting also makes a *binding recommendation* to the General Meeting of Shareholders for the appointment of members of the Board of Management and the Supervisory Board, which can be overruled by the General Meeting of Shareholders as set out before.

Preference shares and the Stichting Preferente Aandelen Philips

The *authorized share capital* of the Company consists of ten priority shares, 3,250,000,000 ordinary shares and 3,249,975,000 preference shares. The *Stichting Preferente Aandelen Philips ('the Foundation')* has been granted the *right to acquire preference shares* in the Company. The mere notification that the Foundation wishes to exercise its rights, should a third party ever seem likely to gain a controlling interest in the Company, will result in the preference shares being effectively issued. The Foundation may exercise this right for as many preference shares as there are ordinary shares in the Company outstanding at that time. The object of the Foundation is to represent the interests of the Company, the enterprises maintained by the Company and its affiliated companies within the Philips Group, such that the interests of Philips, those enterprises and all parties involved with them are safeguarded as effectively as possible, and that they are afforded maximum protection against influences which, in conflict with those interests, may undermine the autonomy and identity of Philips and those enterprises, and also to do anything related to the above ends or conducive to them.
The *members of the self-electing Board of the Foundation* are Messrs J.R. Glasz, S.D. de Bree, W.E. Scherpenhuijsen Rom, L.C. van Wachem and G.J. Kleisterlee. As Chairman of the Supervisory Board and the Board of Management respectively, Messrs Van Wachem and Kleisterlee are members of the Board ex officio. Mr Kleisterlee is not entitled to vote.
The Board of Management of the Company and the Board of the Stichting Preferente Aandelen Philips declare that they are jointly of the opinion that the Stichting Preferente Aandelen Philips is *independent* of the Company as required by the Listing Requirements of Euronext Amsterdam N.V.'s stock market.

The Philips Group in the last nine years

all amounts in millions of euros unless otherwise stated

Due to factors such as consolidations and divestments, the amounts, percentages and ratios are not directly comparable.

General data

	US GAAP					Dutch GAAP				
	2002	2001	2000	1999	1998*	1998*	1997	1996	1995	1994
Sales	**31,820**	32,339	37,862	31,459	30,459	30,459	29,658	27,094	25,259	23,768
Percentage increase over previous year	**(2)**	(15)	20	3	3	3	9	7	6	2
Income (loss) from continuing operations [1]	**(3,206)**	(2,475)	9,577	1,595	1,025	541	1,231	126	971	683
Discontinued operations [2]	**–**	–	–	–	4,891	5,054	263	202	247	281
Cumulative effect of change in accounting principle	**–**	–	85	–	–	–	–	–	–	–
Net income (loss)	**(3,206)**	(2,475)	9,662	1,590	5,900	6,053	2,602	(268)	1,143	964
Turnover rate of net operating capital	**2.43**	2.15	3.12	3.20	2.95	2.91	2.84	2.70	2.88	2.95
Total employees at year-end (in thousands)	**170**	189	219	227	234	234	252	250	253	241
Salaries, wages and social costs paid	**8,183**	8,119	8,479	8,111	8,117	8,209	8,261	8,083	7,363	7,031

Income

	2002	2001	2000	1999	1998*	1998*	1997	1996	1995	1994
Income (loss) from operations	**420**	(1,395)	4,258	1,553	1,289	685	1,714	422	1,350	1,227
As a % of sales	**1.3**	(4.3)	11.2	4.9	4.2	2.2	5.8	1.6	5.3	5.2
As a % of net operating capital (RONA)	**3.2**	(9.3)	35.1	15.8	12.5	6.5	16.4	4.2	15.4	15.2
Income taxes	**(27)**	428	(563)	(208)	(162)	(41)	(276)	7	(74)	(135)
As a % of income before taxes	**(1)**	19	9	14	17	11	20	(40)	7	16
Income (loss) after taxes	**(1,834)**	(1,882)	5,688	1,238	816	332	1,119	25	964	696
As a % of sales	**(5.8)**	(5.8)	15.0	3.9	2.7	1.1	3.8	0.1	3.8	2.9
Income (loss) from continuing operations	**(3,206)**	(2,475)	9,577	1,595	1,025	541	1,231	126	971	683
As a % of stockholders' equity (ROE)	**(19.2)**	(11.9)	48.5	10.9	9.7	5.1	15.9	1.9	15.8	12.5
Per common share in euros	**(2.51)**	(1.94)	7.30	1.16	0.71	0.38	0.88	0.09	0.71	0.51
Net income (loss)	**(3,206)**	(2,475)	9,662	1,590	5,900	6,053	2,602	(268)	1,143	964
Per common share in euros	**(2.51)**	(1.94)	7.36	1.15	4.10	4.20	1.86	(0.20)	0.84	0.72
Dividend paid per common share in euros (related to prior financial year)	**0.36**	0.36	0.30	0.25	0.23	0.23	0.18	0.18	0.14	0.06

* The Company adopted application of US GAAP as from January 1, 2002. The years from 1998 onwards have been restated accordingly. Previous years have not been restated. For the convenience of the reader the 1998 figures are presented on the basis of both US and Dutch GAAP.

[1]) Under Dutch GAAP, prior to 1999, certain material transactions, such as disposals of lines of activities, were accounted for as extraordinary items, whereas under US GAAP these would have been recorded in income (loss) from (continuing) operations.

[2]) Discontinued operations reflect the effect of the sale of PolyGram N.V. in 1998 in order to present the Philips Group accounts on a continuing basis.

Definitions

Net operating capital: intangible assets, property, plant and equipment, non-current receivables and current assets excl. cash and cash equivalents, securities and deferred tax positions, after deduction of provisions and other liabilities

RONA: income from operations as a % of average net operating capital

ROE: income from continuing operations as a % of average stockholders' equity

Net debt: long-term and short-term debt net of cash and cash equivalents

Net debt : group equity ratio: the % distribution of net debt over group equity plus net debt

Average number of outstanding shares: weighted average number of outstanding common shares based on monthly positions during the reporting year

The financial statements have been prepared in euros. Amounts previously reported in Dutch guilders are reported in euros using the irrevocably fixed conversion rate which became effective on January 1, 1999 (EUR 1 = NLG 2.20371).

Capital employed

	US GAAP					Dutch GAAP				
	2002	2001	2000	1999	1998*	1998*	1997	1996	1995	1994
Cash and cash equivalents	**1,858**	890	1,089	2,331	6,553	6,553	1,397	785	932	940
Receivables	**5,671**	6,670	6,806	6,453	5,442	5,442	5,464	5,369	4,890	4,567
Inventories	**3,522**	4,290	5,279	4,268	4,017	4,274	4,522	4,334	5,083	4,330
Current assets	**11,051**	11,850	13,174	13,052	16,012	16,269	11,383	10,488	10,905	9,837
Non-current financial assets	**7,395**	11,033	11,306	7,400	2,871	2,836	1,451	1,618	1,358	1,257
Net assets discontinued operations	**–**	–	–	–	–	–	1,482	1,198	1,013	901
Non-current receivables	**2,772**	3,080	2,713	2,326	1,920	1,920	1,858	1,662	1,413	1,397
Property, plant and equipment (book value)	**6,137**	7,718	9,041	7,332	6,597	6,574	6,935	6,719	6,094	5,599
Intangible assets (book value)	**4,934**	5,521	3,290	1,563	609	554	213	222	198	105
Non-current assets	**21,238**	27,352	26,350	18,621	11,997	11,884	11,939	11,419	10,076	9,259
Total assets	**32,289**	39,202	39,524	31,673	28,009	28,153	23,322	21,907	20,981	19,096
Property, plant and equipment:										
Capital expenditures for the year	**1,161**	2,143	3,170	1,662	1,634	1,634	1,627	2,185	2,127	1,535
Depreciation for the year	**1,782**	1,969	1,789	1,548	1,615	1,615	1,492	1,437	1,218	1,270
Capital expenditures : depreciation	**0.7**	1.1	1.8	1.1	1.0	1.0	1.1	1.5	1.7	1.2
Inventories as a % of sales	**11.1**	13.3	13.9	13.6	13.2	14.0	15.2	16.0	20.1	18.2
Outstanding trade receivables, in months' sales	**1.3**	1.5	1.5	1.4	1.3	1.3	1.3	1.3	1.5	1.5

Financial structure

	2002	2001	2000	1999	1998*	1998*	1997	1996	1995	1994
Other liabilities	**7,836**	8,234	8,764	8,262	6,751	6,779	6,328	5,768	5,643	5,373
Debt	**7,109**	7,866	4,027	3,314	3,587	3,587	4,030	5,855	4,756	3,875
Provisions	**3,246**	3,740	3,557	3,056	2,973	2,985	3,251	3,420	3,460	3,566
Total provisions and liabilities	**18,191**	19,840	16,348	14,632	13,311	13,351	13,609	15,043	13,859	12,814
Issued, paid-up capital	**263**	263	263	339	1,672	1,672	1,655	1,600	1,566	1,536
Surplus and reserves	**13,656**	18,897	22,444	16,369	12,784	12,888	7,499	4,985	5,060	4,410
Stockholders' equity	**13,919**	19,160	22,707	16,708	14,456	14,560	9,154	6,585	6,626	5,946
Minority interests	**179**	202	469	333	242	242	559	279	496	336
Group equity	**14,098**	19,362	23,176	17,041	14,698	14,802	9,713	6,864	7,122	6,282
Total equity and liabilities	**32,289**	39,202	39,524	31,673	28,009	28,153	23,322	21,907	20,981	19,096
Net debt : group equity ratio	**27:73**	26:74	11:89	5:95	**	**	21:79	42:58	35:65	32:68
Stockholders' equity per common share in euros	**10.91**	15.04	17.69	12.55	10.02	10.09	6.39	4.74	4.85	4.41
Market price per common share at year-end	**16.70**	33.38	39.02	33.75	14.30	14.30	13.80	7.94	6.58	5.83

** Not meaningful: net cash in 1998 exceeded the debt level