KONINKLIJKE PHILIPS ELECTRONICS NV
Form 20-F
February 25, 2013
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As filed with the Securities and Exchange Commission on February 25, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

(Mark one)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-05146-01

KONINKLIJKE PHILIPS ELECTRONICS N.V.

(Exact name of Registrant as specified in charter)

ROYAL PHILIPS ELECTRONICS

(Translation of Registrant s name into English)

The Netherlands

(Jurisdiction of incorporation or organization)

Breitner Center, Amstelplein 2, 1096 BC Amsterdam, The Netherlands

(Address of principal executive office)

Eric Coutinho, Chief Legal Officer & Secretary to the Board of Management

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares par value	New York Stock Exchange
Euro (EUR) 0.20 per share	

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

Class	Outstanding at December 31, 2012
Koninklijke Philips Electronics N.V.	957,132,962 shares, including
Common Shares par value EUR 0.20 per share	42,541,687 treasury shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. x Yes ¨ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934. ¨ Yes x No

Note-Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ¨ Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ¨ International Financial Reporting Standards as issued by by the International Accounting Standards Board x Other ¨

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. ¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

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IFRS basis of presentation

The financial information included in this document is based on IFRS, unless otherwise indicated.

Forward-looking statements and other information

Please refer to Forward-looking statements, of this report for more information about forward-looking statements, third-party market share data, fair value information, IFRS basis of preparation, use of non-GAAP information, statutory financial statements and management report, and reclassifications.

Dutch Financial Markets Supervision Act

This document comprises regulated information within the meaning of the Dutch Financial Markets Supervision Act *(Wet op het Financieel Toezicht).*

Statutory financial statements and management report

The chapters Group financial statements and Company financial statements contain the statutory financial statements of the Company. The introduction to the chapter Group financial statements sets out which parts of this Annual Report form the Management report within the meaning of Section 2:391 of the Dutch Civil Code (and related Decrees).

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Introduction

This document contains, among other things, information required for the annual report on Form 20-F for the year ended December 31, 2012 of Koninklijke Philips Electronics N.V. (the 2012 Form 20-F.) Reference is made to the Form 20-F cross reference table herein. Only (i) the information in this document that is referenced in the Form 20-F cross reference table, (ii) this introduction, the cautionary statement concerning forward-looking statements and explanation on use of non-GAAP information on the next two pages and (iii) the Exhibits shall be deemed to be filed with the Securities and Exchange Commission for any purpose. Any additional information herein which is not referenced in the Form 20-F cross reference table, or the Exhibits themselves, shall not be deemed to be so incorporated by reference, shall not be part of the 2012 Form 20-F and is furnished to the Securities and Exchange Commission for information only.

The terms Philips , the Group , we , our and us refer to the Company and as applicable to its subsidiaries and or its interest in joint ventures an associates.

IFRS based information

The audited consolidated financial statements as of December 31, 2012 and 2011, and for each of the years in the three-year period ended December 31, 2012, included in the 2012 Form 20-F have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU). All standards and interpretations issued by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee effective year-end 2012 have been endorsed by the EU, except that the EU did not adopt certain paragraphs of IAS 39 applicable to certain hedge transactions. Philips has no hedge transactions to which these paragraphs are applicable. Consequently, the accounting policies applied by Philips also comply fully with IFRS as issued by the IASB.

Non-GAAP information

In presenting and discussing the Philips Group s financial position, operating results and cash flows, management uses certain non-GAAP financial measures such as: comparable growth; adjusted income from operations; net operating capital; net debt; cash flow before financing activities; net capital expenditures and free cash flow. These non-GAAP financial measures should not be viewed in isolation as alternatives to the equivalent IFRS measure and should be used in conjunction with the most directly comparable IFRS measure(s). Reference is made to the section titled Use of non-GAAP information for further information.

Third-party market share data

Statements regarding market share, contained in this document, including those regarding Philips competitive position, are based on outside sources such as specialized research institutes, industry and dealer panels in combination with management estimates. Where full year information regarding 2012 is not yet available to Philips, those statements may also be based on estimates and projections prepared by outside sources or management. Rankings are based on sales unless otherwise stated.

Fair value information

In presenting the Philips Group s financial position, fair values are used for the measurement of various items in accordance with the applicable accounting standards. These fair values are based on market prices, where available, and are obtained from sources that are deemed to be reliable. Readers are cautioned that these values are subject to changes over time and are only valid at the balance sheet date. When quoted prices or observable market values do not exist, fair values are estimated using valuation models, which we believe are appropriate for their purpose. They require management to make significant assumptions with respect to future developments which are inherently uncertain and may therefore deviate from actual developments. Critical assumptions used are disclosed in the financial statements. In certain cases, independent valuations are obtained to support management s determination of fair values.

Documents on display

It is possible to read and copy documents referred to in the 2012 Form 20-F that have been filed with the SEC at the SEC s public reference room located at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. Philips SEC filings are also publicly available through the SEC s website at www.sec.gov.

For definitions and abbreviations reference is made to chapter 18, Definitions and abbreviations, of this report.

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Introduction

Forward-looking statements

Pursuant to provisions of the United States Private Securities Litigation Reform Act of 1995, Philips is providing the following cautionary statement.

This document, including the information referred to in the Form 20-F cross reference table, 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, in particular, among other statements, certain statements in Item 4 Information on the Company with regard to management objectives, market trends, market standing, product volumes, business risks, the implementation of our Accelerate! program, the statements in Item 8 Financial Information relating to legal proceedings, the statements in Item 5 Operating and financial review and prospects with regard to trends in results of operations, margins, overall market trends, risk management, exchange rates and statements in Item 11 Quantitative and qualitative disclosures about market risks relating to risk caused by derivative positions, interest rate fluctuations and other financial exposure are forward-looking in nature. Forward-looking statements can be identified generally as those containing words such as anticipates , assumes , believes , estimates , expects , should , will , will likely result , forecast , outlook , projects , may or similar expressions. By their na forward-looking statements involve risk and uncertainty, because they relate to events that 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, domestic and global economic and business conditions, developments within the euro zone, the successful implementation of our strategy and our ability to realize the benefits of this strategy, our ability to develop and market new products, changes in legislation, legal claims, changes in exchange and interest rates, changes in tax rates, pension costs and actuarial assumptions, raw materials and employee costs, our ability to identify and complete successful acquisitions and to integrate those acquisitions into our business, our ability to successfully exit certain businesses or restructure our operations, the rate of technological changes, political, economic and other developments in countries where Philips operates, industry consolidation and competition.

As a result, Philips actual future results may differ materially from the plans, goals and expectations set forth in such forward-looking statements. For a discussion of factors that could cause future results to differ from such forward-looking statements, reference is made to the information in Item 3D Risk Factors .

Use of non-GAAP information

Koninklijke Philips Electronics N.V. (the Company) believes that an understanding of sales performance is enhanced when the effects of currency movements and acquisitions and divestments (changes in consolidation) are excluded. Accordingly, in addition to presenting nominal growth , comparable growth is provided.

Comparable sales exclude the effects of currency movements and changes in consolidation. As indicated in the section 12.10, Significant accounting policies, sales and income are translated from foreign currencies into the Company s reporting currency, the euro, at the exchange rate on transaction dates during the respective years. As a result of significant currency movements during the years presented, the effects of translating foreign currency sales amounts into euros could have a material impact on our sales figures. Therefore, these impacts have been excluded in arriving at the comparable sales in euros. Currency effects have been calculated by translating previous years foreign currency sales amounts into euros at the following year s exchange rates in comparison with the sales in euros as historically reported. The years under review were characterized by a number of acquisitions and divestments, as a result of which activities were consolidated or deconsolidated. The effect of consolidation changes has also been excluded in arriving at the comparable sales. For the purpose of calculating comparable sales growth, when a previously consolidated entity is sold or contributed to a venture that is not consolidated by the Company, relevant sales are excluded from impacted prior-year periods. Similarly, when an entity is acquired, relevant sales are excluded from impacted periods.

Philips discusses adjusted income from operations in the 2012 Form 20-F. Adjusted income from operations represents income from operations before amortization and impairment of intangible assets generated in acquisitions (excluding software and capitalized development expenses).

The Company uses the term adjusted income from operations to evaluate the performance of the Philips Group and its sectors. Referencing adjusted income from operations is considered appropriate in light of the following:

Philips has announced that one of its strategic drivers is to increase profitability through re-allocation of its resources towards opportunities offering more consistent and higher returns. Moreover, Philips intends to redeploy capital through value-creating acquisitions. Since 2006, management has used the adjusted income from operations measurement internally to monitor performance of the businesses on a comparable basis. As of 2007, Philips has also set external performance targets based on this measurement as it will not be distorted by the unpredictable effects of future, unidentified acquisitions.

Non US investors are advised that such presentation is different from the terms used in Philips results announcements and 2012 Annual Report. Philips believes that an understanding of the Group s financial condition is enhanced by the disclosure of net operating capital (NOC), as this figure is used by Philips management to evaluate the capital efficiency of the Philips Group and its operating sectors. NOC is defined as: total assets excluding assets from discontinued operations *less*: (a) cash and cash equivalents, (b) deferred tax assets, (c) other (non)-current financial assets, (d) investments in associates, and after deduction of: (e) provisions excluding deferred tax liabilities, (f) accounts and notes payable, (g) accrued liabilities, (h) current/noncurrent liabilities, and (i) trading securities.

Net debt is defined as the sum of long- and short-term debt minus cash and cash equivalents. The net debt position as a percentage of the sum of group equity (shareholders equity and non-controlling interests) and net debt is presented to express the financial strength of the Company. This measure is widely used by management and investment analysts and is therefore included in the disclosure.

Cash flows before financing activities, being the sum total of net cash from operating activities and net cash from investing activities, and free cash flow, being net cash from operating activities minus net capital expenditures, are presented separately to facilitate the reader s understanding of the Company s funding requirements.

Net capital expenditures comprise of purchase of intangible assets, expenditures on development assets, capital expenditures on property, plant and equipment and proceeds from disposals of property, plant and equipment. This measure is widely used by management to calculate free cash flow.

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Form 20-F cross reference table

Only (i) the information in this document that is referenced in the Form 20-F cross reference table, (ii) the Introduction, the cautionary statements concerning Forward-looking statements and explanation on use of non-GAAP information, of this report on pages 5-7, and (iii) the Exhibits shall be deemed to be filed with the Securities and Exchange Commission for any purpose. The content of Philips websites and other websites referenced herein should not be considered to be a part of or incorporated into the 2012 Form 20-F. Any additional information which is not referenced in the Form 20-F cross reference table or the Exhibits themselves shall not be deemed to be so incorporated by reference, shall not be part of the 2012 Form 20-F and is furnished to the Securities and Exchange Commission for information only.

The table below sets out the location in this document of the information required by SEC Form 20-F. The exact location is included in the column Location in this document . The column Page includes the starting page of the section/paragraph for reference only.

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Performance highlights

Performance highlights

Prior periods amounts have been revised to reflect a voluntary adopted accounting policy change, and immaterial adjustments (see section 12.10, Significant accounting policies, of this report)

Financial table

all amounts in millions of euros unless otherwise stated

	2010	2011	2012
Sales	22,287	22,579	24,788
Adjusted IFO[1)]	2,556	1,680	1,502
as a % of sales	11.5	7.4	6.1
IFO	2,074	(269)	1,030
as a % of sales	9.3	(1.2)	4.2
Net income (loss)	1,448	(1,291)	231
per common share in euros:			
- basic	1.54	(1.36)	0.25
- diluted	1.53	(1.36)	0.25
Net operating capital[1)]	11,897	10,372	9,307
Free cash flows[1)]	1,358	(104)	1,723
Shareholders equity	15,007	12,316	11,140
Employees at December 31	119,775	125,241	118,087
of which discontinued operations	3,610	3,353	

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report
2) For a definition of mature and growth geographies, see chapter 18, Definitions and abbreviations, of this report
3) Group Management & Services sector has been renamed to Innovation, Group & Services
4) Based on 60 pulse surveys conducted in 2012

Message from the CEO

Message from the CEO

Accelerate! is gaining good traction and delivering tangible results. We are improving the time-to-market of new innovations and creating value propositions with greater local relevance in key markets around the world. We will continue to relentlessly drive operational excellence and invest in innovation and sales development to deliver profitable growth. **Frans van Houten**, CEO

Dear stakeholder,

Philips is a fantastic company with significant potential still to be fully unlocked. We hold leadership positions in the domains of healthcare, lighting and consumer well-being. Global trends and challenges such as the demand for affordable healthcare, the need for energy efficiency, and the desire for personal well-being offer us tremendous opportunities, in both growth and mature geographies. We have talented and engaged people, exceptional innovation capabilities, a strong and trusted brand, presence in over 100 countries, and a solid balance sheet, all of which differentiate us in the market and significantly strengthen our businesses.

We continue to see ourselves as a case of self-help as we have considerable scope for operational improvement that will drive higher growth and better returns. Through our multi-year transformation program Accelerate! we are making progress in unlocking this potential, including a rigorous approach to portfolio management to ensure that we invest in the best value-creating opportunities and exit less attractive businesses.

2012 a year of significant progress

With the addition of Deborah DiSanzo and Eric Rondolat as CEO of Healthcare and Lighting respectively, we have completed our Executive Committee a diverse team that is fully motivated to transform Philips into the leading technology company in health and well-being.

Accelerate! is gaining good traction and delivering tangible results. We are improving the time-to-market of new innovations and creating value propositions with greater local relevance in key markets around the world. We are redirecting resources to areas where we have identified opportunities to create value and win in the market.

We are also transforming our processes to create lean end-to-end customer value chains. We are reducing our working capital requirements, including a significant reduction in inventory in 2012. Our cost reduction program aimed specifically at reducing overhead and support costs is delivering ahead of target, with cumulative savings of EUR 471 million in 2012.

And we are creating a growth and performance culture by taking decisions faster, fostering entrepreneurial behavior, and taking a granular approach to business planning and performance management, fully anchored by our General Business Principles. Our reward system has been aligned to reflect the focus on growth and improved performance.

I am delighted that the organization is responding well to Accelerate! all of these actions are making Philips a more customer-focused, agile, entrepreneurial innovator.

We posted 4% comparable sales growth in 2012, despite ongoing economic challenges and market weakness, especially in the United States and Europe. Our growth geographies made a strong and increasing contribution (35% of sales, up from 33% in 2011).

Our underlying operational profitability improved, driven by sales growth and higher productivity of non-manufacturing costs. Reported Adjusted IFO was significantly impacted by various charges, as well as restructuring costs. We substantially improved our return on invested capital.

Healthcare did well in 2012, recording 6% comparable sales growth, as well as importantly improved profitability at its Imaging Systems business. The growth businesses in our Consumer Lifestyle sector, i.e. Personal Care, Health & Wellness and Domestic Appliances, delivered solid growth, including a significant contribution from 2011 acquisitions in growth geographies. Lighting posted a further increase in LED-based sales and made progress in addressing underperforming units, with Lumileds and Consumer Luminaires returning to profitability excluding restructuring and acquisition-related charges in the fourth quarter. Innovation is a key driver of future LED-based applications and solutions, and we were proud to launch our personal wireless LED lighting system Philips hue. Reinforcing our commitment to innovation, we increased our investments in Research & Development from EUR 1.6 billion (7.1% of sales) in 2011 to EUR 1.8 billion (7.3% of total sales) in 2012.

Reshaping our Consumer Lifestyle portfolio was an important step in the transformation of Philips to become the leading technology company in health and well-being. Our Television joint venture with TPV became operational in 2012. This was followed by the announcement of a distribution agreement with Funai for Lifestyle Entertainment in North America. In January 2013 we announced an agreement with Funai on the transfer of our audio, video, multimedia and accessories businesses. This agreement will leverage the strengths of both companies to improve the position of Philips Audio/ Video Entertainment in the market, providing continuity for our customers and brand license income for Philips.

As we strive to make the world healthier and more sustainable through innovation, we again delivered on our EcoVision commitments and helped improve the lives of 1.7 billion people in 2012. Our ongoing efforts in this area were recognized when we were named Supersector leader in the Dow Jones Sustainability Index for the second consecutive year. In the annual Interbrand ranking of the top 100 global brands, we increased our brand value by 5% to over USD 9 billion, the highest in the history of our brand.

In 2012 we continued to execute our EUR 2 billion share buy-back program, which will improve the efficiency of our balance sheet, and by the end of the year we had completed 73% of this program.

Reflecting our confidence in Philips future, we are proposing to the upcoming General Meeting of Shareholders to maintain this year s dividend at EUR 0.75 per common share, in cash or stock.

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Message from the CEO

Looking ahead our path to value in 2013 and beyond

As we pursue our mission and vision, we are confident that the strategic direction we have chosen is sound. We are bringing many exciting new products and services to the market in all three of our sectors. We will continue with Accelerate! to make us more competitive and to enable our businesses to win in the market and achieve global leadership positions. It is the right platform to drive the execution of our plans and to ensure that our investments in innovation, people, systems and markets deliver profitable growth and improve return on invested capital.

In the coming year we will make further progress through Accelerate! by transforming our end-to-end customer value chain to just four Lean-based business models enabled by an effective and cost-efficient IT platform. This is helping us to deliver our innovations to market faster and reducing our working capital requirements. Our end-to-end projects will scale up to cover over 40% of sales in 2013, up from around 20% in 2012.

We are also implementing focused actions to improve gross margins in 2013 and beyond. These include rationalizing our industrial and distribution footprint at Lighting and Healthcare, enhancing procurement effectiveness and driving value engineering.

In conclusion, we made considerable progress in 2012, but there is still much to be done to deliver Philips full potential. We are confident that operational and financial performance will improve further during 2013, enabling us to achieve our targets for the year.

On behalf of my colleagues on the Executive Committee, I wish to thank our employees for their dedicated efforts and for the way they have embraced our new culture of entrepreneurship and accountability. And I would like to thank our customers and other stakeholders, especially our shareholders, for their continuing support.

Frans van Houten,

Chief Executive Officer

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1 Our company

Philips is a diversified technology company active in the markets of healthcare, lighting and consumer well-being. Our headquarters are in Amsterdam (Netherlands).

Our heritage

Philips was founded in Eindhoven (Netherlands) in 1891 by Frederik and Gerard Philips later joined by Gerard s brother Anton to manufacture incandescent lamps and other electrical products . For the 120-plus years since then, we have been enhancing people s lives with a steady flow of ground-breaking innovations. And we are determined to build upon this rich heritage as we aspire to touch billions of lives each year with our innovative lighting and healthcare solutions and our consumer well-being products.

Our mission

To improve people s lives through meaningful innovation

Innovation is core to everything we do. But innovation does not only mean new technology . It can also mean a new application, a new business model or a unique customer proposition brought about by an innovative partnership. By tracking global trends and understanding the challenges facing people in their daily lives, we ensure that people s needs and aspirations remain at the heart of our innovation endeavors.

Our vision

At Philips, we strive to make the world healthier and more sustainable through innovation. Our goal is to improve the lives of 3 billion people a year by 2025. We will be the best place to work for people who share our passion. Together we will deliver superior value for our customers and shareholders.

Guiding statement

As a diversified technology company we manage a dynamic portfolio of businesses which we build to global leadership performance.

We create value through our capabilities to develop deep understanding of our customers needs and apply advanced technologies to create innovative solutions. With our people, global presence and trusted brand we reach customers worldwide.

The Philips Business System enables us to deliver superior results by being a learning organization with a growth and performance culture, in which we combine entrepreneurship and agility with disciplined, lean end-to-end execution, leveraging global scale and local relevance.

Our behaviors

Our behaviors:

- Eager to win
- Take ownership
- Team up to excel

are designed to foster a new performance culture and help all of us accelerate to deliver sustainable profitable growth always in compliance with Philips General Business Principles.

Our company

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External recognition

Philips and its businesses received a tremendous number and variety of awards and other forms of recognition in 2012. The following are just a few examples from a very successful year:

- Equal highest-ever placing (41st) on the annual Interbrand ranking of the world s most valuable brands
- Philips named Supersector leader in the Dow Jones Sustainability Index for the second consecutive year
- Philips won a record-breaking number of 124 design awards in 2012
- MD Buyline: Customers rated Philips Computed Tomography the #1 vendor in the health care industry for Q2, Q3 and Q4 2012; Philips Ultrasound #1 and Philips PROS #1 in Q3 and Q4 2012; Philips Radiography & Fluoroscopy #1 in Q1 and Q2 2012
- KLAS: November 2012 RSNA Report on Philips Magnetic Resonance Imaging Ingenia 1.5 T ranked #1
- KLAS: Philips Ultrasound #1 Best in KLAS award in general imaging and ultrasound cardiology
- 2012 IMV ServiceTrak All Systems survey: Philips Ultrasound ranked #1 based on customer feedback
- American Association for Respiratory Care Zenith Award, Philips Hospital Respiratory Care
- In China, Consumer Care of Consumer Lifestyle was recognized as the The Best in Consumer Care 2012 by 51callcenter.com
- UK consumer magazine *Which?* ranked Philips kettles, irons and Gaggia espresso machines #1 for reliability
- Lumea Precision won the Beauty Astir Award for Best Body Product
- CityTouch online outdoor lighting management system honored as a top sustainable solution at Rio+20 United Nations Conference on Sustainable Development
- US business magazine *Forbes* named our Philips hue personal wireless lighting system Best Product of 2012

2 Group strategic focus

Philips is a technology company with a focus on people s health and well-being. We strive for a balanced portfolio of businesses that have or can attain global leadership positions and deliver performance at or above benchmark levels.

A number of trends and challenges are influencing our business activities and portfolio choices:

Global trends and challenges our market opportunities

Philips applies its outstanding innovation capabilities, global footprint, talented and engaged people, deep knowledge of customers and specific industry domains, and strong brand to provide solutions that address these needs and challenges and have a meaningful impact on people s lives.

Lives improved

At Philips, we strive to make the world healthier and more sustainable through innovation. Our goal is to improve the lives of 3 billion people a year by 2025.

Where technology and human needs intersect that is where we find meaningful innovation. Meeting people s needs through technology means re-imagining livable cities with smarter, more energy-efficient lighting, and developing new approaches to healthcare that promote wellness rather than simply treat illness. It means a focus on health and well-being innovations that are more intuitive, more effective, more affordable and accessible.

Our technology, often conceived and developed in collaborative Open Innovation, gives us smart tools to drive far-reaching positive change intelligent energy, circular economic production, patient-focused healthcare. And with technology trending towards greater personalization and connectedness, we are increasingly incorporating digital intelligence into our products and solutions.

To guide our efforts and measure our progress, we take a two-dimensional approach social and ecological to improving people s lives. Products and solutions from our portfolio that directly support the curative (care) or preventive (well-being) side of people s health, determine the contribution to the social dimension. As healthy ecosystems are also needed for people to live a healthy life, the contribution to the ecological dimension is determined by means of our Green Product portfolio, such as our energy-efficient lighting.

Lives improved by Philips: 1.7 billion

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2 Group strategic focus 2 - 2

The Philips Business System

Centered around our company mission, vision and guiding statement, the Philips Business System links four elements into a coherent system: Our overall Group Strategy and the resulting portfolio choices and resource allocation. Our five Capabilities, Assets and Positions, Philips unique strenghts: deep customer insight, technology innovation, our brand, global footprint, and our people. To collectively leverage these unique strengths, we rigorously apply common operating principles across the Group to achieve Philips Excellence . This in turn maximizes the value we can create, value that we can then reinvest in our portfolio of businesses, leading to further strengthening of our CAPs.

As such, the Philips Business System acts as a virtuous cycle in which all four elements continually reinforce one another, accelerating profitable growth of all businesses within it. In this way, we steadily build, over time, the momentum needed to maximize the value we create for us as a company, for our customers, shareholders and society as a whole.

Core principles

The following eight principles describe how we operate the Philips Business System:

We manage our portfolio with clearly defined strategies and allocate resources to maximize value creation.

We strengthen and leverage our core Capabilities, Assets & Positions as they create differential value.

We define and execute business plans that deliver sustainable results along a credible Path to Value.

We govern through Business-Market Combinations and a single value-added layer.

We serve our customers with speed & excellence through lean, process-driven end-to-end value chains.

We run a single, granular, performance management cycle with aligned objectives and rewards.

We champion our Growth and Performance Culture, always acting with integrity.

We embrace continuous improvement and learning to enhance our capabilities.

Business Market Combinations

As a diversified technology group, Philips has a wide portfolio of categories/business innovation units which are grouped in business groups based primarily on technology or customer needs. Philips has physical market presence in over 100 countries, which are grouped into 17 market clusters. Our primary operating modus is the Business Market matrix comprising Business Groups and Markets. These Business Market Combinations (BMCs) drive business performance on a granular level at which plans are agreed between global businesses and local market teams.

Single value-added layer

To optimize our overhead structure, we adopt a single value-added layer above the BMCs. Group and Sector are effectively one layer: staff are shared, not layered or duplicated. The goal is to do the same work only once, i.e. no duplication of roles and responsibilities.

Accelerate!

Accelerate! is our comprehensive multi-year change and performance improvement program designed to transform Philips and unlock our full potential for long-term success.

Based upon a renewed culture of entrepreneurship and accountability, Accelerate! is reducing the complexity of our organization, tightening customer focus, increasing empowerment and collaboration between businesses and markets with the right resources to win, and increasing the speed and excellence of innovation and end-to-end execution. Through Accelerate! we are creating an agile, entrepreneurial and innovative company that delivers meaningful, locally relevant products and solutions to our customers. At the same time, our costs efficiency need to be at least in line with that of our competitors.

Our Accelerate! mid-term 2013 financial targets

We measure value through a balanced combination of sales growth, profitability and capital usage (the latter two measured through return on invested capital) in conjunction with other financial, operational and strategic key performance indicators.

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Set in 2011 as part of the Accelerate! program, our mid-term financial targets, to be realized by the end of 2013, are:

- Comparable sales growth CAGR of 4-6%, assuming real GDP growth of 3-4% per annum
- Reported Adjusted IFO margins of 10-12% for the Group; 15-17% for Healthcare; 8-10% for Consumer Lifestyle (excluding unrelated licenses); 8-10% for Lighting
- Return on invested capital of 12-14%

3 Our strategy in action

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Driving progressive health care

Through innovation in live image-guidance technology, Philips is enabling minimally invasive procedures that were not possible before opening up new ways to treat disease and improve the quality of life for millions worldwide.

Many health conditions that once required open surgery can be treated far less invasively today, minimizing physical trauma to patients, allowing faster recovery and improving outcomes. Helping drive this trend is the application of X-rays, ultrasound and other imaging technologies to guide interventional procedures, which use specialized devices to diagnose and treat patients at the site of disease and trauma. From repairing fractures of the spine to treating blood vessels around the heart, clinicians need live image guidance when performing a minimally invasive intervention in order to see real-time on a monitor where they are and what they are doing in the patient s body.

Enabling safer, more effective procedures

Minimally invasive medicine is the future of progressive health care, and at Philips we are leading the way in live image-guidance technology, delivering relevant clinical value where it is needed most. For example, by integrating multi-modality images at the point of treatment, our solutions offer exceptional image clarity and deep insight opening the door to new clinical procedures for safer, more effective diagnosis and treatment in a number of specialties.

These solutions include our new EchoNavigator[1], which leverages our leadership in interventional X-ray and echocardiography technology. The combination of these two live modalities in a unique and intuitive way enables a more efficient and straightforward method for treating structural heart disease, a condition that affects millions of people around the world.

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AlluraClarity with ClarityIQ technology[2] is another of our recent breakthroughs in live image guidance. Developed in collaboration with interventional physicians and introduced in 2012, it directly addresses the ongoing concern of radiation dose level for patients and exposure to clinical staff during interventions.

Traditionally, lower radiation doses have translated into lesser image quality in interventional procedures. In a field where image clarity is critical, AlluraClarity with ClarityIQ does a superior job of maintaining image quality at significantly reduced doses.

These and other advances in imaging are helping drive the transition from open to minimally invasive surgery for better clinical and economic outcomes, while transforming disease management for countless patients.

Live image guidance is just one example of how Philips is transforming the future of health care, said Gene Saragnese, Executive Vice President and CEO, Philips Imaging Systems. The combination of innovation leadership, clinical partnership and an entrepreneurial approach has created demand in the market for our disruptive technology. It is what drives us every day to deliver the best possible patient outcome while improving the overall clinical experience.

1. Not available in the US; pending FDA 510(k) clearance
2. Not available in the US

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Transforming critical care delivery

Philips works closely with health systems to improve quality, costs and access to care across multiple patient settings. By leveraging our leadership in healthcare technology, we are transforming critical care for war veterans.

In the US, the Veterans Integrated Service Network (VISN) 23 is one of 21 health systems operated by the Department of Veterans Affairs (VA) to provide a broad spectrum of medical care to the nation s war veterans. Serving more than 400,000 veterans in ten Midwestern states, VISN 23, like other health systems across the country, faces the ongoing challenge of providing accessible, quality care while lowering costs against the backdrop of a critical care resource shortage.

Nowhere are these issues more evident than in an intensive care unit (ICU), where at-risk patients require specialized care, immediate attention and constant monitoring. It is also where a vast amount of patient data is generated. The typical ICU patient is often connected to more than a half dozen bedside medical devices from different manufacturers that run on different software. To make the best informed decisions, clinicians need to be able to view all of the data coming from these devices and in different formats clearly and in one place. Yet for many healthcare facilities, the process of integrating, aggregating and analyzing this amount of data remains tedious and time-consuming.

A seamlessly integrated solution

When VISN 23 outlined its initial mission to improve critical care delivery across seven of its medical centers, Philips Healthcare immediately recognized the need to bring together two different technology platforms in patient monitoring and clinical informatics in a single, seamless solution that could be delivered using innovative telehealth technology.

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Our aim was to enable better use of limited resources, more effective collaboration and greater accountability to drive early intervention during the critical care period. In doing so, we would not only empower VISN 23 medical teams to provide a higher level of care to a broader base of veterans, we would also help minimize the risk of repeated hospital admissions, reducing cost of care.

With this in mind, in 2012 we implemented a solution that combines our IntelliSpace Critical Care and Anesthesia bedside charting product and eICU platform. IntelliSpace Critical Care and Anesthesia is an advanced decision-support and documentation solution that interfaces with VistA, the VA s electronic medical record (EMR) system. It transforms patient data into actionable information through seamless interoperability while automatically populating patient EMRs for more than 100 ICU beds across the VISN 23 system. Building on the VA s commitment to remote patient monitoring, eICU allows monitoring of all VISN 23 ICUs from a control center staffed by critical care specialists at the Minneapolis VA Medical Center. Both solutions are integrated so that data entered into IntelliSpace Critical Care and Anesthesia is available in eICU.

This state-of-the-art solution provides a vital layer of service and support in diagnosing and treating high-risk patients, said Mike Mancuso, Executive Vice President and CEO, Philips Patient Care & Clinical Informatics. It also demonstrates the power of Philips telehealth technology to not only change how care is being delivered to patients, but also enable clinicians to take advantage of other innovations designed to improve patient outcomes and experiences.

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End-to-end journey with Wal-Mart

In North America we are working together with Wal-Mart to optimize every step in the value chain of our Male Grooming business. This end-to-end approach is transforming our relationship and benefiting Wal-Mart shoppers.

Philips Norelco is the leading brand in the electric shaver market in North America. Continuing to strengthen the business, Male Grooming North America embarked on an end-to-end journey with three key areas of focus: understanding the consumer, partnering with our customer to grow our businesses together, and transforming our business so that it is faster and more responsive to specific local needs.

Step by step

We started by taking a granular look at consumer needs and aspirations in the North American market. Armed with breakthrough insights, we then turned to Wal-Mart, one of our largest customers.

The shaving and grooming aisle is important to Wal-Mart to meet the needs of their male shoppers. They also seek to cater to the diverse consumer needs of the American population, supporting their store of the community strategy.

Next, we reviewed our own performance, finding significant opportunities to optimize our end-to-end value chain in terms of lead time, inventory, and cost of non-quality.

The final step was to make the change happen. We are moving from a push to a pull inventory model, enabling our North American business to order only what it really needs for its customers and resulting in significantly lower inventories. We have also stepped up investment in our

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marketing capabilities and resources in North America. And crucially, we are spending more time talking with Wal-Mart.

Straight talking, fruitful dialog

The impact of this end-to-end journey has been significant, as Michael Smith, Senior Director for Personal Care at Wal-Mart, explains: The shaving aisle for Wal-Mart is very important as almost all American males aged 16 and older buy products from these categories. I see tremendous potential when we combine Philips ability to innovate and create demand for new products with our collective ability to simplify the shelf.

If we really collaborate, it s about getting deep with our customer, understanding what they re looking for and how we can help bring it to life at our store with your brands. And I think that s probably been the biggest change I ve seen from Philips: taking a step back and looking at what s important to us as a customer and finding a way to deliver it over a long-term horizon.

Our relationship today with Philips has changed a great deal, and much of that centers around the fact that we ve got into some very honest and candid conversations. One of the great things about end-to-end is that it forces us both to get more focused on the shopper, digging deep and really understanding what our consumer needs, what their different needs are, and how we can bring it to shelf in a product that they will leave our store more satisfied with.

Dedicated solution

As part of Wal-Mart s store of the community strategy, our team has now developed our first product to address the specific shaving needs of African-American men, such as ingrown hairs. By working with Wal-Mart and leveraging partners like Bump Patrol, a highly successful skincare brand among African-American men, we have brought this exciting new proposition to life with launch scheduled for Q1 2013!

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A recipe for profitable growth

Across the world, we are driving growth in Kitchen Appliances by building global scale through local relevance, leveraging acquisitions, and forming alliances to offer new experiences in the preparation of fresh, healthy food.

At IFA 2012 in Berlin we announced a multi-year partnership with world-famous chef Jamie Oliver to co-design a new range of appliances that takes the strain out of life in the kitchen. The first product of this exciting collaboration is the Philips HomeCooker, a multi-functional device designed to help busy families enjoy tasty, fresh, home-cooked meals while being able to spend more quality time together. The HomeCooker does all the hard work, so you don t have to. It chops, stirs, steams and sautés it even switches off and keeps food warm until it is ready to be served.

We all know it can be a struggle to get fresh, homemade food on the table every day, especially for busy parents who have to juggle so much. It s often a real tradeoff between spending time with the family and getting fresh food on the table, explains Jamie Oliver. The beauty of the Philips HomeCooker is that it removes this dilemma you can now do both!

Jamie Oliver is a champion of delicious home-cooked food and has been campaigning for many years to get families to eat good, fresh home-made food. This makes for a perfect fit with our commitment to enhance the health and well-being of today s families through meaningful innovation.

From global innovation platform to local market success and back

With five regional product creation hubs, we continue to accelerate the introduction of innovations that are tailored to the specific eating habits of cultures around the world. Indeed, since 2010 we have quadrupled the number of launches of locally relevant innovations.

With sales of over one million units in less than two years, the Airfryer has been a huge success as a healthy reduced-fat and odor-free alternative to oil-fried foods. It is also a great example of how a global proposition can be

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3 Our strategy in action 3 - 3

successfully adapted to local cuisines being used for traditional dishes such as chicken samosas in India, chicken wings in China, and chocolate cake in the UK.

And proving that innovation can be a two-way street, our soy milk platform, developed locally for consumers in China, has now been adapted for European consumers to make soup.

Successfully integrating acquisitions

In 2012 we built upon the previous year s acquisitions of Povos (China) and Preethi (India). Povos end-to-end capability has expanded the Philips brand offering in Chinese cuisine, driving over 30% growth in Philips-branded kitchen appliances, as well as halving time-to-market. Furthermore, a number of products based on Povos rice cooker innovation platform have been launched outside China, such as the Multicooker in Russia, which has been tailored to meet the specific culinary needs of Russian households.

In India, Preethi s product-creation capability has strengthened Philips kitchen appliances market leadership: we are now the clear market leader in the important mixer-grinder category, with a market share in excess of 30%. And we are further leveraging Preethi s brand equity, launching Preethi-branded products for the south Indian diaspora across the Middle East and ASEAN, as well as expanding the portfolio in India to include garment care products.

Re-inventing lighting for consumers

Driven by the shift toward connected, digital lighting solutions and applications, we are strengthening our presence in the consumer market by leveraging our innovative capability to add ever greater value with light.

For more and more of us, home is the hub of our social and leisure activities. Lighting for the home is about much more than merely turning a switch on or off it s about allowing consumers to truly personalize their interior spaces. Today s flexible, efficient digital lighting can transform a room in an instant, creating a pleasant ambience and enhancing the very way we feel. And it delivers significant energy savings when used to replace conventional lighting, taking some of the strain off household budgets.

New way to experience and interact with light

As we continue to redefine and extend the possibilities of LED technology, the October 2012 launch of Philips hue has pushed the boundaries of lighting even further. Initially available exclusively from Apple stores, Philips hue the world s first commercially available web-enabled home lighting system enables users to control light wirelessly with an app on their smartphone or tablet. This opens up endless possibilities for consumers to creatively personalize their lighting to suit their lifestyle. The app also features four pre-programmed light settings based on our research into the biological effects of light on the body. These scenarios set the LED bulbs to the optimum tone and brightness of white light to help us relax, read, concentrate or energize. Just as phones, media and entertainment have been revolutionized by digital technology, now consumers can also personalize light and enjoy limitless applications.

In the spirit of Open Innovation, we have opened up the hue app to the developer community, inviting developers to explore the app and come up with yet more innovative new ways to enhance life with light.

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New era, new opportunities

Connectivity, interoperability and outstanding light quality are key to opening up new opportunities and business models in the brave new world of digital lighting. Building upon our heritage of over 120 years as a pioneer in lighting, we remain dedicated to unlocking the full potential of light through meaningful innovation and stylish design.

Design is invariably a major factor in the consumer s choice of lighting. With LEDs being so small, designers are no longer limited by the form factor of legacy light sources. And this design freedom is creating new possibilities for consumers to define their own style and identity.

In 2012 we demonstrated our leadership in the field of consumer luminaire design yet again, winning an unprecedented nine iF and six red dot design awards, as well as a number of other awards. iF and red dot awards are renowned throughout the world as a seal of good design. Our *Lirio by Philips* Balanza luminaire range was particularly successful, winning both a coveted Gold iF award *and* a red dot award. Also part of the *Lirio by Philips* range, our eye-catching Nick-Knack line of LED floor lights is minimalistic in design yet has maximum impact, allowing the user to create different light effects simply by adjusting the angle of the top section.

Going forward, we will use our strong position in LED lamp technology and luminaire design, as well as our application know-how, to drive further life-enhancing innovations and so set the standard for the consumer s experience of light in the home.

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Enhancing urban life with light

Guided by our vision of a healthier and more sustainable world, we are combining our market leadership in LED luminaires with intelligent lighting management and controls to enhance people s lives and add value to business.

A century ago less than one in ten of the world s population lived in a city. By the start of the 21st century this figure had risen to over 50%, and by 2050 over two thirds of us will be living in cities. In the face of this rapid urbanization, our energy-efficient, intelligent lighting can help create safe, smart, vibrant and ecologically sound city environments.

Energy efficiency

Today, lighting accounts for 19% of the world s electricity consumption with some 60% used for commercial and public buildings in cities, and around 15% for street lighting. Significant savings on average 40% and up to 90% in individual projects can be made simply by switching to energy-efficient lighting technologies like LED.

Globally, the potential electricity cost savings amount to EUR 128 billion, leading to a reduction in CO_2 emissions of 670 million tonnes.

Luminaire design innovation

Thanks to their small size, LEDs have opened up tremendous opportunities for innovative luminaire design. Now, luminaires like our FreeStreet LED luminaire winner of the 2011 Dutch Design Award can blend into the urban landscape, freeing up space and decluttering urban areas. FreeStreet is unusual because the LED lamps are actually integrated into the cable, creating a floating effect.

Eindhoven has opted for FreeStreet because the floating lighting system is adapted to the way people move and behave, rather than people having to adapt to where the lighting is located. I think this is a good example of technological progress, says Mary-Ann Schreurs, Municipal Executive Councillor for Innovation, Culture and Public Spaces.

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Intelligent lighting

As lighting goes digital, we are combining our innovative LED lamps and luminaires with smart lighting controls and software in fully integrated, intelligent solutions for cities. Intelligent lighting provides the right amount of light precisely *where* it is needed and *when* it is needed. Our LumiMotion solution, for example, combines LED luminaires with motion sensors to deliver light on demand . Such context-aware adaptive lighting enables municipal authorities to save on energy and maintenance costs and to reduce obtrusive light, while improving public perception of safety.

Inspiring environments

Our integrated LED-based lighting solutions also offer exceptional freedom in terms of controlled lighting effects color, dynamics, brightness, etc. This is driving a shift from quantitative functional lighting towards qualitative emotive lighting that transforms urban environments. Leveraging the digitalization of light, we are applying our industry-leading expertise in LED lighting control across a range of segments enabling exciting new shopper experiences, creating personalized office workspaces, and bringing to life iconic landmarks like the Empire State Building.

Innovation for smart and sustainable solutions

High-quality and intelligently connected lighting helps make a city safer, more attractive and more sustainable, thus enhancing its brand identity the distinctive signature that defines its appeal and sets it apart from other cities. This not only increases civic pride, but also attracts new residents, new businesses and investment that can boost retailing, tourism and other drivers of economic growth and employment.

4 Our planet, our partners, our people

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The power to make a difference

We have been engaging with stakeholders from global political and industrial leaders at the UN Climate summit to local community leaders in rural Africa to highlight the benefits of our locally relevant and affordable innovations.

One of our main vehicles for stakeholder engagement in 2012 was our third Cairo to Cape Town roadshow, which travelled 12,000 kilometers across Africa raising awareness of how our lighting and healthcare solutions improve the quality of people s lives. We engaged in dialogue with customers, governments, NGOs and media on key challenges facing Africa the need for energy-efficient lighting, mother and child care, women s healthcare and showcased how our innovations can help address these.

Enhancing life after dark

More than 500 million Africans live without electricity. For people living near the equator, darkness falls around 7 pm all year round, slowing down or completely stopping many vital activities. By highlighting the benefits of LED and solar lighting, we illustrated how our solutions can resolve this problem and help tackle some of the major issues confronting Africa, such as energy efficiency, climate change and resource scarcity.

We committed an investment of EUR 2 million, spread over three years, to a new initiative which will see the installation of 100 light centers across rural Africa by 2015 as part of the UN s Sustainable Energy for All program. These light centers are areas of approximately 1,000 m^2 the size of a small soccer pitch which are lit using a new generation of highly efficient solar-powered LED lighting. The idea is to create areas of light for rural communities that live without electricity, thus effectively extending the day and creating opportunities for social, sporting and economic activities in the evening, as well as increasing safety at night, particularly for women and children. We have already installed several of these light centers in countries including Egypt, Morocco, Ghana, Kenya and South Africa.

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The creation of light centers is also an integral part of a three-year partnership we have entered into with the Royal Dutch Football Association (KNVB) to help expand their WorldCoaches program in rural Africa and South America. WorldCoaches trains soccer coaches in using the game for social development, focusing on communities in developing countries.

In six cities en route to Cape Town we also partnered with Right To Play a global organization that uses the transformative power of play to educate and empower children facing adversity on a soccer tournament that took place under our solar-powered LED floodlights.

Providing clinical training

In support of UN Millennium Development Goals 4 and 5, which aim to reduce child mortality rates and improve maternal health, we also used the roadshow to deliver clinical education on baby resuscitation, fetal monitoring and clinical ultrasound, and to train over 1,200 healthcare practitioners on how to accomplish safe childbirths and improve maternal and infant care.

The road ahead

Philips remains dedicated to continuing the engagements, partnerships and commitments we have made on this journey, says JJ van Dongen, CEO Philips Africa. We are committed to an aggressive multiyear investment plan to significantly increase our business footprint in the coming years, based upon locally relevant products and innovations that address the needs of the growing African population.

Encouraging positive change

In addition to our own sustainability activities, we also work to influence our suppliers and their suppliers towards better sustainability practices. To that end, we are active in many supply chain initiatives around the world.

Philips is one of the initiators of the IDH Electronics Program, a multi-stakeholder initiative sponsored by the Sustainable Trade Initiative (IDH) together with Dell, Hewlett-Packard, and civil society organizations. Working with more than 100 electronics suppliers in China, this program steers away from traditional auditing methods and seeks to make a transformative impact by building and up-scaling the capabilities of both workers and management. By enhancing worker-management dialogue and developing employees skills and careers, the program seeks to reduce employee turnover, increase worker satisfaction, boost energy efficiency, and improve overall performance of supplier factories.

We are also a member of the Electronic Industry Citizenship Coalition (EICC), which promotes an industry code of conduct to improve working and environmental conditions within global supply chains. Today, the EICC includes more than 50 global electronics companies and their suppliers.

Consistent recognition

In 2012, the Dutch Association of Investors for Sustainable Development (VBDO) once again recognized our efforts in responsible supply chain management. VBDO ranked Philips the top performer among 40 of the largest publicly-listed companies in the Netherlands. Our scores have shown continual improvement over the last six years, rising from 62% in 2006 to the highest score ever of 96% in 2012.

A powerful recent example

The economy of the Democratic Republic of the Congo (DRC) has collapsed due to decades of conflict. In an attempt to prevent the country s rich supply of minerals, including tin, from being used to finance war, many corporations around the world have desisted from buying minerals from the DRC, creating a de facto embargo. To overcome this problem and to promote cooperation and economic growth in the region beyond rebel control we helped launch the Conflict-Free Tin Initiative in September 2012. One month later, an important milestone was reached when the first bags of tagged minerals left a non-rebel-controlled mine in the DRC.

Philips is continuing to make an active contribution in this area through our membership of the Extractives Work Group, a joint effort of the EICC and GeSI (Global eSustainability Initiative). This work group seeks to positively influence social and environmental conditions in the global metals extractives supply chain. In 2012 we also participated in the multi-stakeholder OECD-hosted pilot to test the implementation of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. Furthermore, we continue to engage with relevant Congolese organizations as well as non-government organizations in Europe and the US on this issue.

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Embracing culture change

Through the Accelerate! program, Philips is driving structural change with a renewed company culture as the foundation for performance improvement and growth, explains Carole Wainaina, Chief HR Officer.

Culture is the glue that bonds a company s employees together it is the very DNA of the organization. The creation of a growth and performance culture is central to Accelerate!, the multi-year transformation program designed to make us a more agile, entrepreneurial and innovative company and bring us closer to our customers.

To realize our ambitions, we need highly motivated, passionate employees who display entrepreneurial spirit, the desire to excel, and a bold determination to succeed. These traits are articulated in our Accelerate! behaviors *Eager to win*, *Take ownership* and *Team up to excel*.

With the implementation of Accelerate!, Philips is moving away from a one size fits all company culture which has tended to inhibit growth, to a culture that drives performance one that is focused on results and characterized by honest dialogues, fact-based conclusions and fast action. This will enable us to adapt quickly to changing market conditions and outpace the competition.

Change begins at the top

Leaders play a crucial role in driving change within an organization. From role modeling to recognizing and rewarding the desired behaviors, employees look to their leaders for direction. That s why over 700 of our leading executives have participated in the Accelerate! Leadership Program. This immersive program is designed to strengthen our leaders change management capabilities so they can, in turn, lead change in the organization. In our rapidly changing world, we see these capabilities as crucial to success.

Embedding the culture

To truly change behaviors, our systems and processes need to be adjusted accordingly. We have, therefore, embedded our new behaviors in our HR processes, e.g. our People Performance Management recognition and reward system. And we have changed the annual incentive system for executives to reflect line-of-sight accountability and aligned it with the key performance indicators of our Accelerate! mid-term 2013 financial targets.

At the same time, we are augmenting our talent management initiatives and focusing on the development of a learning organization. For example, by upgrading and expanding the various core, functional and market training curricula offered to our employees.

Tracking progress

To understand exactly where we are on our Accelerate! journey, we have launched a quarterly Change Adoption survey. The survey provides us with a good indication of what is going well in order to build on it further and indicates where we need to improve. This supports the momentum for our transformation.

Living the culture

Ultimately, Accelerate! is all about transforming ourselves so that we can continue to be a great company today, tomorrow, and a hundred years from now. Our renewed culture will make a decisive contribution in this regard, by helping to make Philips an even more dynamic and rewarding place for talented, dedicated, passionate people to work.

5 Group performance

2012 was a year of progress despite the challenging economic environment, especially in the United States and Europe. Supported by our Accelerate! transformation program, we achieved 4% comparable sales growth and improved our net income, capital efficiency and free cash flow. The results in 2012 demonstrate momentum on our path towards our Accelerate! mid-term 2013 financial targets.

Ron Wirahadiraksa, CFO

5.1 Financial performance

Management summary

Key data[1)]

in millions of euros unless otherwise stated

	2010	2011	2012
Sales	22,287	22,579	24,788
Adjusted IFO[2)]	2,556	1,680	1,502
as a % of sales	11.5	7.4	6.1
IFO	2,074	(269)	1,030
as a % of sales	9.3	(1.2)	4.2
Financial income and expenses	(121)	(240)	(246)
Income tax expense	(497)	(283)	(308)
Results of investments in associates	18	16	(214)
Income (loss) from continuing operations	1,474	(776)	262
Income (loss) from discontinued operations	(26)	(515)	(31)
Net income (loss)	1,448	(1,291)	231
Net income (loss) per common share in euros:			
basic	1.54	(1.36)	0.25
diluted	1.53	(1.36)	0.25
Net operating capital (NOC)[2)]	11,897	10,372	9,307
Cash flows before financing activities[2)]	1,477	(525)	1,286
Employees (FTEs)	119,775	125,241	118,087
of which discontinued operations	3,610	3,353	

1) Prior periods amounts have been revised to reflect a voluntarily adopted accounting policy change, and immaterial adjustments throughout Annual Report, see section 12.10, Significant accounting policies, of this report
2) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

The year 2012

Despite strong economic headwinds, we continued on our steady path of improvement driven by our multi-year change and performance program, Accelerate!. We recorded 4% comparable sales growth (10% nominal growth), with a strong contribution from growth geographies. Healthcare and Consumer Lifestyle delivered solid earnings, while Lighting gained momentum in its turnaround. Net income for the year amounted to EUR 231 million, and was impacted by substantial restructuring charges as well as the European Commission fine related to alleged violation of competition rules in the Cathode-Ray Tube (CRT) industry.

Sales amounted to EUR 24.8 billion, a 10% nominal increase for the year. Excluding favorable currency effects and portfolio changes, comparable sales were 4% above 2011, driven by all three operating sectors. Healthcare sales grew 6%, with solid growth in all businesses. Lighting sales were 4% above 2011, with strong growth coming from Light Sources & Electronics, mainly fueled by market demand for LED, and Automotive, partly tempered by a sales decline at Lumileds. Sales at Consumer Lifestyle were 2% above 2011, with double-digit growth at Domestic Appliances and Health & Wellness and mid-single-digit growth at Personal Care, tempered by a sales decline at our Lifestyle Entertainment business.

Our growth geographies achieved 10% comparable growth, while mature geographies grew by a modest 1%, as a result of the overall macroeconomic developments and the continued weakness of the Western European markets, particularly Southern Europe. In 2012, growth geographies accounted for 35% of total sales, compared to 33% in 2011.

IFO amounted to EUR 1,030 million, or 4.2% of sales, compared to a loss of EUR 269 million, or negative 1.2% of sales, in 2011. Excluding impairment charges of EUR 1,355 million in 2011, significant IFO improvement was seen at Consumer Lifestyle and Healthcare, while Lighting was impacted by charges related to restructuring activities.

We continued to re-align our portfolio to further focus on expanding market-leadership positions across our Healthcare, Consumer Lifestyle and Lighting sectors. In 2012, we completed the divestment of our Television business to TP Vision, extended our partnership in Senseo with Sara Lee and strengthened our Lifestyle Entertainment platform in North America through the signing of a distribution agreement with Funai. Additionally, we completed the acquisition of Indal, strengthening our position in outdoor lighting. In January 2013 we announced an agreement to transfer our Audio, Video, Multimedia and Accessories businesses to Funai.

In 2012 we generated EUR 2,198 million of cash flow from operating activities, which was EUR 1,430 million higher than in 2011. The increase was largely a result of lower working capital requirements and higher cash earnings. Our cash flows before financing activities were EUR 1,811 million above the level of 2011, due to higher cash flow from operating activities, higher proceeds from divestments, and lower outflows related to acquisitions of new businesses.

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The year 2011

2011 was a challenging year for Philips, in which financial performance was impacted by overall market weakness, particularly in Western Europe towards the end of the year. We recorded 4% comparable sales growth (1% nominal), with a strong contribution from growth geographies, while largely as a result of continued investments for growth, gross margin pressure and goodwill impairments we saw earnings decline compared to the previous year. The net loss for the year amounted to EUR 1,291 million, which was mainly attributable to lower earnings, impairment charges in the second quarter of the year and costs related to the discontinued operations of the Television business as a result of the signing of a joint venture agreement with TPV.

Sales amounted to EUR 22.6 billion, a 1% nominal increase for the year. Excluding unfavorable currency effects and portfolio changes, comparable sales were 4% above 2010. Comparable sales growth was driven by Lighting and Healthcare, while Consumer Lifestyle sales were in line with the previous year. Within Lighting, strong growth was seen in the Professional Lighting Solutions business, mainly fueled by the construction market in growth geographies, and the Light Sources & Electronics business, partly mitigated by a sales decline at Lumileds. Healthcare sales grew 5%, with solid growth in all businesses, particularly Patient Care & Clinical Informatics. Sales at Consumer Lifestyle were slightly above 2010, with improvement seen mainly in the second part of the year, where strong growth at Health & Wellness, Personal Care and Domestic Appliances was tempered by a sales decline in our Lifestyle Entertainment business.

Our growth geographies achieved comparable 11% growth, while mature geographies grew by a modest 1%, as a result of the overall macro-economic developments and weakness of the Western European markets. In 2011 growth geographies accounted for 33% of total sales, compared to 31% in 2010.

IFO amounted to a loss of EUR 269 million, or minus 1.2% of sales, compared to EUR 2,074 million, or 9.3% of sales, in 2010. IFO decline was mainly seen at Lighting and Healthcare, largely as a result of EUR 1,355 million of goodwill impairment charges taken in the second quarter of 2011, as well as lower operational earnings in all sectors. The latter was mainly due to continued pressures on gross margin, reflecting challenging economic conditions as well as higher investments for future growth.

We continued to invest in strategically aligned companies, primarily to strengthen our product portfolio in growth geographies. In 2011, we completed six acquisitions, contributing to all three sectors, notably Preethi and Povos in Consumer Lifestyle and Sectra in Healthcare. The cash outflow related to acquisitions amounted to EUR 552 million.

In 2011 we generated EUR 768 million of cash flow from operating activities, which was EUR 1,306 million lower than in 2010. The decline was largely a result of the lower cash earnings and higher working capital requirements mainly related to tightening the accounts payable procedures and the timing of tax payable, which was partly mitigated by lower inventory build. Our cash flows before financing activities were EUR 2,002 million below the level of 2010, due to lower cash flow from operating activities, lower proceeds from the sale of stakes and interests, and higher outflow related to acquisitions of new businesses and capital expenditures.

In July 2011 we launched a EUR 2 billion share buy-back program aimed at improving the efficiency of our balance sheet.

5.1.1 Sales

The year 2012

The composition of sales growth in percentage terms in 2012, compared to 2011, is presented in the table below.

Sales growth composition 2012 versus 2011

in %

	comparable growth	currency effects	consolidation changes	nominal growth
Healthcare	6.4	6.4		12.8
Consumer Lifestyle	1.7	3.8	0.5	6.0
Lighting	3.8	4.6	2.1	10.5
IG&S[1)]	(7.4)	0.1	(6.2)	(13.5)
Philips Group	4.1	5.0	0.7	9.8

1) Group Management & Services sector has been renamed to Innovation, Group & Services

Group sales amounted to EUR 24,788 million in 2012, representing 10% nominal growth compared to 2011.

Adjusting for a 5% favorable currency effect and a 1% favorable portfolio effect, comparable sales were 4% above 2011. Comparable sales were up 6% at Healthcare, while Lighting was 4% higher and Consumer Lifestyle was 2% higher than the previous year.

Healthcare sales amounted to EUR 9,983 million, which was EUR 1,131 million higher than in 2011, or 6% higher on a comparable basis. Higher sales were driven by solid mid-single-digit comparable growth in all businesses, as increases in growth geographies and North America were tempered by flat sales in Western Europe.

Consumer Lifestyle reported sales of EUR 5,953 million, which was EUR 338 million higher than in 2011, or 2% higher on a comparable basis. We achieved double-digit growth at Domestic Appliances and Health & Wellness and mid-single-digit growth at Personal Care. This was partly offset by a double-digit decline at Lifestyle Entertainment, where growth was tempered by a slowdown in consumer spending, particularly in mature geographies.

Lighting sales amounted to EUR 8,442 million, which was EUR 804 million higher than in 2011, or 4% higher on a comparable basis. Growth was largely driven by high-single-digit growth at Automotive and mid-single-digit growth at Light Sources & Electronics. This was tempered by low-single-digit growth at Professional Lighting Solutions and Consumer Luminaires and a sales decline at Lumileds.

IG&S reported sales of EUR 410 million, which was EUR 64 million lower than in 2011, due to the divestment of Assembléon in the prior year and lower royalty income.

The year 2011

The composition of sales growth in percentage terms in 2011, compared to 2010, is presented in the table below.

Sales growth composition 2011 versus 2010

in %

	comparable growth	currency effects	consolidation changes	nominal growth
Healthcare	5.3	(2.5)	0.1	2.9
Consumer Lifestyle	1.1	(1.8)	2.7	2.0
Lighting	6.1	(2.3)	(2.7)	1.1
IG&S	(10.7)	(0.1)	(14.0)	(24.8)
Philips Group	4.1	(2.2)	(0.6)	1.3

Group sales amounted to EUR 22,579 million in 2011, representing 1% nominal growth compared to 2010.

Adjusting for a 2% unfavorable currency effect and a 1% unfavorable portfolio effect, comparable sales were 4% above 2010. Comparable sales were 6% higher at Lighting and 5% higher at Healthcare, but this was tempered by Consumer Lifestyle, where sales were 1% higher than the previous year.

Healthcare sales amounted to EUR 8,852 million, which was 5% higher than in 2010 on a comparable basis. Higher sales were driven by mid-single-digit growth at all businesses, as increases in growth geographies and North America were largely offset by lower sales in Western Europe and other mature geographies.

Consumer Lifestyle reported sales of EUR 5,615 million, which was EUR 111 million higher than in 2010, or 1% higher on a comparable basis. We achieved double-digit growth at Health & Wellness and Personal Care and high single-digit growth at Domestic Appliances. This was offset by a sales decline at Lifestyle Entertainment.

Lighting sales amounted to EUR 7,638 million, which was EUR 86 million higher than in 2010, or 6% higher on a comparable basis. Growth was largely driven by high single digit growth at Professional Lighting Solutions and Light Sources & Electronics. This was tempered by sales declines at Lumileds and Consumer Luminaires.

IG&S reported sales of EUR 474 million, which was EUR 156 million lower than in 2010, mainly due to the divestment of Assembléon in the first quarter of 2011. Excluding Assembléon and other portfolio changes, sales were 11% lower than in 2010 on a comparable basis, attributable to lower royalty income.

5.1.2 Earnings

The year 2012

In 2012, Philips gross margin was EUR 9,409 million, or 38.0% of sales, compared to EUR 8,734 million, or 38.7% of sales, in 2011. Gross margin in 2012 included EUR 296 million in restructuring and acquisition-related charges, whereas 2011 included EUR 53 million in restructuring and acquisition-related charges. Gross margin percentage was higher than in 2011 for Consumer Lifestyle and Healthcare, while Lighting was lower.

Selling expenses increased from EUR 5,247 million in 2011 to EUR 5,468 million in 2012. 2012 included EUR 194 million in restructuring and acquisition-related charges, compared to EUR 54 million of restructuring charges in 2011. The year-on-year increase was mainly attributable to restructuring activities and higher expenses aimed at supporting a higher level of sales. In relation to sales, selling expenses decreased from 23.2% to 22.1%. Selling expenses as a percentage of sales were lower in all sectors.

General and administrative expenses amounted to EUR 798 million in 2012, compared to EUR 841 million in 2011. As a percentage of sales, costs decreased from 3.7% in 2011 to 3.2%.

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Research and development costs increased from EUR 1,610 million in 2011 to EUR 1,810 million in 2012. The year-on-year increase was largely attributable to higher investments in growth and innovation. As a percentage of sales, research and development costs increased from 7.1% in 2011 to 7.3% in 2012.

The overview below shows sales, IFO and Adjusted IFO according to the 2012 sector classifications.

Sales, IFO and Adjusted IFO

in millions of euros unless otherwise stated

	sales	IFO	%	Adjusted IFO[1)]	%
2012					
Healthcare	9,983	1,122	11.2	1,322	13.2
Consumer Lifestyle	5,953	593	10.0	663	11.1
Lighting	8,442	(6)	(0.1)	188	2.2
IG&S	410	(679)		(671)	
Philips Group	24,788	1,030	4.2	1,502	6.1
2011					
Healthcare	8,852	93	1.1	1,145	12.9
Consumer Lifestyle	5,615	217	3.9	297	5.3
Lighting	7,638	(362)	(4.7)	445	5.8
IG&S	474	(217)		(207)	
Philips Group	22,579	(269)	(1.2)	1,680	7.4

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2012, IFO increased by EUR 1,299 million compared to 2011, to EUR 1,030 million, or 4.2% of sales. 2012 included EUR 580 million in restructuring and acquisition-related charges, compared to EUR 163 million in 2011. The year-on-year increase was mainly attributable to goodwill impairments of EUR 1,355 million in 2011 and higher gross margin percentages in Healthcare and Consumer Lifestyle, but was partly offset by a EUR 313 million fine issued by the European Commission in relation to the alleged violation of competition rules in the Cathode-Ray Tube (CRT) industry.

Amortization of intangibles, excluding software, capitalized product development and impairment related charges, amounted to EUR 472 million in 2012, compared to EUR 594 million in 2011.

Adjusted IFO decreased from EUR 1,680 million, or 7.4% of sales, in 2011 to EUR 1,502 million, or 6.1% of sales, in 2012. Adjusted IFO was higher than in 2011 at Consumer Lifestyle and Healthcare, while Lighting was lower.

Healthcare

Adjusted IFO increased from EUR 1,145 million, or 12.9% of sales, in 2011 to EUR 1,322 million, or 13.2% of sales, in 2012. Adjusted IFO improvements were realized across all businesses, largely as a result of higher sales and reduced expenses resulting from cost-saving programs. Restructuring and acquisition-related charges totaled EUR 134 million, compared to EUR 20 million in 2011.

Consumer Lifestyle

Adjusted IFO increased from EUR 297 million, or 5.3% of sales, in 2011 to EUR 663 million, or 11.1% of sales, in 2012. Restructuring and acquisition-related charges amounted to EUR 75 million in 2012, compared to EUR 54 million in 2011. 2012 results included a EUR 160 million one-time gain from the extension of our partnership with Sara Lee, including the transfer of our 50% ownership rights to the Senseo trademark. Excluding this one-time gain, the year-on-year Adjusted IFO increase was driven by higher sales across all growth businesses as well as lower net costs formerly reported as part of the Television business. Adjusted IFO was higher than in 2011 in all businesses.

Lighting

Adjusted IFO decreased from EUR 445 million, or 5.8% of sales, in 2011 to EUR 188 million, or 2.2% of sales, in 2012. Restructuring and acquisition-related charges amounted to EUR 315 million in 2012, compared to EUR 66 million in 2011. The decrease in Adjusted IFO was mainly attributable to higher restructuring and acquisition-related charges, as well as losses on the sale of industrial assets amounting to EUR 81 million, partly offset by higher sales. Compared to 2011, Adjusted IFO declined in all businesses except Automotive.

Innovation, Group & Services

Adjusted IFO decreased from a loss of EUR 207 million in 2011 to a loss of EUR 671 million in 2012. Results in 2012 were negatively impacted by a charge of EUR 313 million related to the CRT fine and provisions related to various legal matters totaling EUR 132 million. Adjusted IFO in 2012 also includes a EUR 25 million gain from a change in a medical retiree benefit plan and a EUR 37 million gain on the sale of the High Tech Campus, while 2011 included a EUR 21 million gain related to a change in pension plan. Restructuring and acquisition-related charges amounted to EUR 56 million in 2012, compared to EUR 23 million in 2011.

For further information regarding the performance of the sectors, see chapter 6, Sector performance, of this report.

Year 2011

In 2011, Philips gross margin was EUR 8,734 million, or 38.7% of sales, compared to EUR 9,022 million, or 40.5% of sales, in 2010. The decrease in Gross margin in 2011 was primarily attributable to raw material price increases. Gross margin in 2011 included EUR 53 million in restructuring and acquisition-related charges, whereas 2010 included EUR 97 million in restructuring and acquisition-related charges. Gross margin percentage was lower than in 2010 for all sectors, notably Lighting and Consumer Lifestyle.

Selling expenses increased from EUR 4,808 million in 2010 to EUR 5,247 million in 2011. Selling Expenses in 2011 were impacted by a EUR 128 million charge related to the impairment of customer relationships and brand names in Consumer Luminaires, as well as EUR 54 million in restructuring and acquisition-related charges, compared to EUR 75 million in 2010. The year-on-year increase was mainly attributable to higher expenses aimed at driving higher market penetration and increased spending on advertising and promotion. In relation to sales, selling expenses increased from 21.6% to 23.2%. Compared to 2010, selling expenses as a percentage of sales declined in Healthcare, while they were higher in Lighting and Consumer Lifestyle.

General and administrative expenses amounted to EUR 841 million in 2011, compared to EUR 713 million in 2010. As a percentage of sales, costs increased from 3.2% in 2010 to 3.7%.

Research and development costs increased from EUR 1,493 million in 2010 to EUR 1,610 million in 2011. The year-on-year increase was largely attributable to higher investments in growth and innovation. As a percentage of sales, research and development costs increased from 6.7% in 2010 to 7.1%.

The overview below shows 2010 sales, IFO and Adjusted IFO according to the 2012 sector classifications.

Sales, IFO and Adjusted IFO

in millions of euros unless otherwise stated

	sales	IFO	%	Adjusted IFO[1)]	%
2010					
Healthcare	8,601	922	10.7	1,186	13.8
Consumer Lifestyle	5,504	449	8.2	487	8.8
Lighting	7,552	689	9.1	863	11.4
IG&S	630	14		20	
Philips Group	22,287	2,074	9.3	2,556	11.5

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2011, IFO decreased by EUR 2,343 million compared to 2010, to a loss of EUR 269 million, or minus 1.2% of sales. 2011 included EUR 163 million in restructuring and acquisition-related charges, compared to EUR 203 million in 2010. The year-on-year decrease was mainly driven by goodwill impairments of EUR 1,355 million, lower gross margin percentages in Lighting and Consumer Lifestyle, and lower IFO in Innovation, Group & Services.

Amortization of intangibles, excluding software, capitalized product development and impairment-related charges, amounted to EUR 594 million in 2011, compared to EUR 482 million in 2010.

Adjusted IFO decreased from EUR 2,556 million, or 11.5% of sales, in 2010 to EUR 1,680 million, or 7.4% of sales, in 2011. The decrease in Adjusted IFO was attributable to all sectors.

Healthcare

Adjusted IFO decreased from EUR 1,186 million, or 13.8% of sales, in 2010 to EUR 1,145 million, or 12.9% of sales, in 2011. Adjusted IFO improved in Customer Services, Home Healthcare Solutions and PCCI, but was more than offset by lower results in Imaging Systems. Restructuring and acquisition-related charges totaled EUR 20 million, compared to EUR 77 million in 2010.

Consumer Lifestyle

Adjusted IFO decreased from EUR 487 million, or 8.8% of sales, in 2010 to EUR 297 million, or 5.3% of sales, in 2011. Restructuring and acquisition-related charges amounted to EUR 54 million in 2011, compared to EUR 31 million in 2010. The year-on-year Adjusted IFO decrease was largely due to lower sales, particularly in Lifestyle Entertainment, higher investments in advertising and promotion, as well as lower license income. Adjusted IFO was higher than in 2010 in Health & Wellness, while in all other businesses it declined.

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Lighting

Adjusted IFO decreased from EUR 863 million, or 11.4% of sales, in 2010 to EUR 445 million, or 5.8% of sales, in 2011. Restructuring and acquisition-related charges amounted to EUR 66 million in 2011, compared to EUR 97 million in 2010. The decrease in Adjusted IFO was largely attributable to lower gross margin due to raw material price increases, as well as step-ups in investments related to growth.

Innovation, Group & Services

Adjusted IFO decreased from a gain of EUR 20 million in 2010 to a loss of EUR 207 million in 2011. Adjusted IFO in 2010 included a EUR 119 million gain related to a change in pension plan. 2011 results included a EUR 21 million gain from a change in a pension plan, and EUR 23 million in restructuring charges. The year-on-year Adjusted IFO decrease was largely attributable to lower license income, higher pension costs, and provisions for legal and environmental claims.

For further information regarding the performance of the sectors, see chapter 6, Sector performance, of this report.

5.1.3 Marketing

The year 2012

Philips total 2012 marketing expenses approximated EUR 890 million, a decrease of 5% compared to 2011, mainly due to decreased investments in Western Europe. Consistent with 2011, the Company allocated a higher proportion of its total marketing spend towards growth geographies and strategic markets, priority areas for the Company s growth strategy. Accordingly, the Company increased its marketing spend in key growth geographies by 5% compared to 2011. Total 2012 marketing investment as a percentage of sales approximated 3.6%, compared to 4.2% in 2011.

Philips increased its brand value by 5% in 2012 to over USD 9 billion in the ranking of the world s 100 most valuable brands, as measured by Interbrand. In the 2012 listing, Philips maintained its ranking as the 41st most valuable brand in the world.

The year 2011

Philips total 2011 marketing expenses approximated EUR 938 million, an increase of 12% compared to 2010. Consistent with 2010, the company allocated a higher proportion of its total marketing spend towards growth geographies and strategic markets, priority areas for the company s growth strategy. Accordingly, the company increased its marketing spend in growth geographies by 15% compared to 2010. Philips also continued to align its businesses around customers and markets, maintaining its level of local marketing investment as a percentage of sales at approximately 5% in growth geographies in both 2010 and 2011. Total 2011 marketing investment as a % of sales approximated 4.2%, compared to 3.7% in 2010.

5.1.4 Research and development

The year 2012

Research and development costs increased from EUR 1,610 million in 2011 to EUR 1,810 million in 2012. The year-on-year increase was largely attributable to higher investments in growth and innovation, including an increased focus on new value spaces. As a percentage of sales, research and development costs increased from 7.1% in 2011 to 7.3%.

Research and development costs within Healthcare increased EUR 63 million, mainly at Imaging Systems and Home Healthcare Solutions. At Lighting, research and development costs increased EUR 44 million, primarily at Lumileds and our Controls business within Professional Lighting Solutions. At Consumer Lifestyle, research and development spending was EUR 12 million lower than in 2011, mainly as a result of the re-positioning of the Lifestyle Entertainment portfolio. In Innovation, Group & Services, R&D expenses increased by EUR 105 million, driven by investments in new value spaces as well as innovation and design initiatives.

Research and development expenses per sector

in millions of euros

	2010	2011	2012
Healthcare	698	740	803
Consumer Lifestyle	282	313	301
Lighting	355	409	453
Innovation, Group & Services	158	148	253
Philips Group	1,493	1,610	1,810

The year 2011

In 2011, research and development costs amounted to EUR 1,610 million, or 7.1% of sales, compared with EUR 1,493 million, or 6.7% of sales in 2010.

Healthcare R&D spend increased by EUR 42 million in 2011, mainly due to higher investments in Imaging Systems and Patient Care & Clinical Informatics. In Consumer Lifestyle, R&D increased by EUR 31 million, mainly focused on driving category leadership positions within Personal Care, Health & Wellness and Domestic Appliances. In Lighting, R&D investment was higher by 15%, or EUR 54 million compared to 2010, largely attributable to investments relating to the LED transformation in Light Sources & Electronics and Lumileds. In IG&S, R&D expenses were lower by EUR 10 million.

5.1.5 Pensions

The year 2012

The net periodic pension costs of defined-benefit pension plans amounted to a credit of EUR 38 million in 2012, compared to a cost of EUR 18 million in 2011. The defined-contribution pension cost amounted to EUR 142 million, EUR 22 million higher than in 2011.

The funded status of our defined-benefit plans improved in 2012, in spite of decreasing discount rates and improved life expectancy assumptions in the Netherlands and UK plans. The surpluses of the plans in the Netherlands and UK increased, but as we do not recognize the surplus in these countries the net balance sheet position was not impacted.

In 2012, a prior-service cost gain of EUR 25 million was recognized in one of our major retiree medical plans. The plan change reduced certain company post-retirement risks. In the Netherlands a curtailment gain was recognized of EUR 25 million in the pension plan in 2012 due to headcount reductions as a result of our restructuring activities. In 2012, further steps were taken to manage the financial exposure to defined-benefit plans such as the buy-out of the Swiss Pension Fund by an insurance company.

The overall curtailment gain for 2011 was EUR 18 million and the prior-service cost gain was EUR 20 million.

For further information, refer to note 29, Pensions and other postretirement benefits.

The year 2011

The net periodic pension costs of defined-benefit pension plans amounted to a cost of EUR 18 million in 2011, compared to a credit of EUR 105 million in 2010. The defined-contribution pension cost amounted to EUR 120 million, EUR 6 million higher than in 2010.

In 2011, further steps were taken to manage the financial exposure to defined benefit plans. One of our major plans was frozen and the active members were transferred to a defined contribution plan, causing a curtailment gain. In the same plan, a prior-service gain was recognized due to retired members opting for a one-off benefit increase in exchange for future indexation. The overall curtailment gain for 2011 was EUR 18 million and the prior-service cost gain was EUR 20 million.

The funded status of our defined benefit plans deteriorated in 2011 due to adverse market movements and lower interest rates. However, this was largely offset by the unrecognized surpluses of the Group s main plans, reducing the impact on the net balance sheet position.

In 2010, results were positively impacted by the recognition of EUR 119 million of negative prior-service costs. These resulted from a reduction of pension benefits expected to be paid in the future, in part due to a change in indexation. In 2010, a curtailment gain of EUR 9 million on one of our retiree medical plans was recognized due to the partial closure of a US site.

For further information, refer to note 29, Pensions and other postretirement benefits.

5.1.6 Restructuring and impairment charges

The year 2012

2012 included EUR 530 million in restructuring and related asset impairment charges. In addition to the annual goodwill impairment tests for Philips, trigger-based impairment tests were performed during the year, resulting in no goodwill impairments.

In 2011, IFO included net charges totaling EUR 1,572 million for restructuring and related asset impairments. The annual impairment test led to selected adjustments of pre-recession business cases as well as an adjustment of the discount rate across Philips, leading to a EUR 1,355 million impairment of goodwill. In addition to the annual goodwill impairment tests for Philips, trigger-based impairment tests were performed during the year, but resulted in no further goodwill impairments. 2011 also included a EUR 128 million charge related to the impairment of customer relationships and brand names at Consumer Luminaires.

For further information on sensitivity analysis, please refer to note 9, Goodwill.

Restructuring and related charges

in millions of euros

	2010	2011	2012
Restructuring and related charges per sector:			
Healthcare	48	3	116
Consumer Lifestyle	12	9	57
Lighting	74	54	301
Innovation, Group & Services	(2)	23	56
Continuing operations	132	89	530
Discontinued operations	30	15	10
Cost breakdown of restructuring and related charges:			
Personnel lay-off costs	151	109	443
Release of provision	(70)	(45)	(37)
Restructuring-related asset impairment	14	10	66
Other restructuring-related costs	37	15	58
Continuing operations	132	89	530
Discontinued operations	30	15	10

In 2012, the most significant restructuring projects related to Lighting and Healthcare and were driven by our change program Accelerate!. Restructuring projects at Lighting centered on Luminaires businesses and Light Sources & Electronics, the largest of which took place in the Netherlands, Germany and in various locations in the US. In Healthcare, the largest projects were undertaken at Imaging Systems and Patient Care & Clinical Informatics in various locations in the United States to reduce operating costs and simplify the organization. Innovation, Group & Services restructuring projects focused on the IT and Financial Operations Service Units (primarily in the Netherlands), Group & Regional Overheads (mainly in the Netherlands and Italy) and Philips Innovation Services (in the Netherlands and Belgium). Consumer Lifestyle restructuring charges were mainly related to Lifestyle Entertainment (primarily US and Hong Kong) and Coffee (mainly Italy).

In 2011, the most significant restructuring projects related to Lighting and Innovation, Group & Services and were mainly driven by our change program Accelerate!. Restructuring projects at Lighting centered on Luminaires businesses and Light Sources & Electronics, the largest of which took place in the Netherlands, Brazil and in the US. Innovation, Group & Services restructuring projects focused on the Global Service Units (primarily in the Netherlands), Corporate and Country Overheads (mainly in the Netherlands, Brazil and Italy) and Philips Design (the Netherlands). At Healthcare, the largest projects were undertaken at Imaging Systems, Home Healthcare Solutions and Patient Care & Clinical

Informatics in various locations in the US to reduce operating costs and simplify the organization. Consumer Lifestyle restructuring charges mainly related to our remaining Television operations in Europe.

For further information on restructuring, refer to note 20, Provisions.

The year 2011

In 2011, IFO included net charges totaling EUR 1,572 million for restructuring and related asset impairments. The annual impairment test led to selected adjustments of pre-recession business cases as well as an adjustment of the discount rate across Philips, leading to a EUR 1,355 million impairment of goodwill. In addition to the annual goodwill impairment tests, trigger-based impairment tests were performed during the year, but resulted in no further goodwill impairments. 2011 also included a EUR 128 million charge related to the impairment of customer relationships and brand names at Consumer Luminaires.

2010 included EUR 132 million in restructuring and related asset impairment charges.

For further information on sensitivity analysis, please refer to note 9, Goodwill.

In 2011, the most significant restructuring projects related to Lighting and Innovation, Group & Services and were mainly driven by our change program Accelerate!.

The restructuring charges in 2010 were mainly attributable to the operating sectors. Within Healthcare, the largest projects related to the reorganization of the commercial organization in Imaging Systems (Germany, the Netherlands and the US). Consumer Lifestyle restructuring charges were mainly in Lifestyle Entertainment, primarily in the Netherlands and the US. Restructuring projects in Lighting were focused on the reduction of production capacity in traditional lighting technologies, such as incandescent. The largest projects were initiated in Brazil, France and the US.

For further information on restructuring, refer to note 20, Provisions.

5.1.7 Financial income and expenses

The year 2012

A breakdown of Financial income and expenses is presented in the table below.

Financial income and expenses

in millions of euros

	2010	2011	2012
Interest expense (net)	(225)	(210)	(241)
Sale of securities	162	51	1
Impairment on securities	(2)	(34)	(8)
Other	(56)	(47)	2
	(121)	(240)	(246)

The net interest expense in 2012 was EUR 31 million higher than in 2011, mainly as a result of higher average outstanding debt.

Sale of securities

in millions of euros

	2010	2011	2012
Gain on sale of NXP shares	154		
Gain on sale of TCL shares		44	
Gain on sale of Digimarc shares		6	
Others	8	1	1
	162	51	1

In 2012 there was a EUR 1 million gain on the sale of securities. In 2011, income from the sale of securities totaled EUR 51 million, including a EUR 44 million gain on the sale of the remaining shares in TCL and a EUR 6 million gain on the sale of shares of Digimarc.

Impairments on securities

in millions of euros

	2010	2011	2012
TPV		(25)	
Chi-Mei Innolux		(4)	(1)
BG Medicine		(2)	(1)
Prime Technology	(2)	(1)	
Tendris			(5)
Gilde III			(1)
Other		(2)	
	(2)	(34)	(8)

Impairment charges in 2012 amounted to EUR 8 million, mainly from shareholdings in Tendris. In 2011, impairment charges amounted to EUR 34 million, mainly from shareholdings in TPV Technologies Ltd.

Other financial income was a EUR 2 million gain in 2012, compared to a net expense of EUR 47 million in 2011. In 2012, there was a EUR 46 million gain related to a change in estimate on the valuation of long-term derivative contracts and remaining other financial income of EUR 20 million. This is offset by EUR 42 million other financing charges and a EUR 22 million accretion expense (mainly associated with discounted provisions).

Other financial expenses in 2011 primarily consisted of a EUR 35 million other financing charge and a EUR 33 million accretion expense (mainly associated with discounted provisions) offset by EUR 11 million dividend income and other financial income, including a net gain of EUR 6 million mostly from the revaluation impact of the option related to NXP.

For further information, refer to note 2, Financial income and expenses.

The year 2011

The net interest expense in 2011 was EUR 15 million lower than in 2010, mainly as a result of lower average outstanding debt.

In 2011, income from the sale of securities totaled EUR 51 million. This included a EUR 44 million gain from the sale of the remaining shares in TCL and a EUR 6 million gain on the sale of shares of Digimarc. In 2010, income from the sale of securities of EUR 162 million was mainly attributable to the sale of NXP shares.

2011 was impacted by impairment charges amounting to EUR 34 million, mainly from shareholdings in TPV Technologies Ltd.

Other financial expenses totaled to a EUR 47 million expense in 2011, compared to EUR 56 million in 2010. In 2011 these primarily consisted of a EUR 35 million other financing charge and a EUR 33 million accretion expense (mainly associated with discounted provisions) offset by EUR 11 million dividend income and other financial income, including a net gain of EUR 6 million mostly from the revaluation impact of the option related to NXP.

Other financial expenses in 2010 primarily consisted of a EUR 21 million expense related to the revaluation of the convertible bonds received from TPV Technology and CBAY, and a EUR 20 million accretion expense mainly associated with discounted provisions.

For further information, refer to note 2, Financial income and expenses.

5.1.8 Income taxes

The year 2012

Income taxes amounted to EUR 308 million, compared to EUR 283 million in 2011. The year-on-year increase was largely attributable to higher taxable earnings.

The tax burden in 2012 corresponded to an effective income tax rate of 39.3%, compared to negative 55.6% in 2011. In 2011, the negative effective income tax rate was attributable to goodwill impairment losses of EUR 1,355 million, which are largely non-tax-deductible. The effective income tax rate in 2012 included the impact of the non-tax-deductible charge of EUR 509 million arising from the European Commission ruling related to the alleged violation of competition rules in the Cathode-Ray Tube (CRT) industry.

For 2013, the effective tax rate excluding incidental non-taxable items is expected to be between 32% and 35%.

For further information, refer to note 3, Income taxes.

The year 2011

Income taxes amounted to EUR 283 million, despite losses incurred for the year, mainly due to goodwill impairment losses, which are largely non-tax-deductible. The tax charge was EUR 214 million lower than in 2010 due to lower taxable earnings, partly offset by higher incidental tax expenses.

The tax burden in 2011 corresponded to an effective income tax rate of negative 55.6%, compared to a positive 25.4% in 2010. The effective income tax rate was negative attributable to goodwill impairment losses of EUR 1,355 million, which are largely non-tax-deductible. Excluding the non-tax-deductible goodwill impairment losses, the effective income tax rate increased mainly due to a change in the mix of profits and losses in various countries, a change in the country mix of income tax rates and higher new loss carry forwards not expected to be realized.

For further information, refer to note 3, Income taxes.

5.1.9 Results of investments in associates

The year 2012

The results related to investments in associates declined from income of EUR 16 million in 2011 to a loss of EUR 214 million in 2012, largely attributable to a charge of EUR 196 million related to the former LG.Philips Displays joint venture.

The European Commission imposed fines in relation to alleged violations of competition rules in the Cathode-Ray Tube industry. Philips recorded a total charge of EUR 509 million, of which EUR 313 million is directly related to Philips and therefore recorded in Income from Operations, while EUR 196 million relates to LG.Philips Displays and is therefore recorded in results of investments in associates.

Results of investments in associates

in millions of euros

	2010	2011	2012
Company s participation in income	14	18	(8)
Results on sale of shares	5		
(Reversal of) investment impairment and other charges	(1)	(2)	(206)
	18	16	(214)

The Company s participation in income decreased from EUR 18 million in 2011 to negative EUR 8 million in 2012. The loss in 2012 was mainly attributable to the results of EMGO, while the income in 2011 was mainly due to the results of Intertrust.

For further information, refer to note 4, Investments in associates.

The year 2011

The results related to investments in associates declined from EUR 18 million in 2010 to EUR 16 million in 2011, largely attributable to the results on the sale of shares of EUR 5 million in 2010.

The company s participation in income increased from EUR 14 million in 2010 to EUR 18 million in 2011, mainly attributable to results on Intertrust.

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For further information, refer to note 4, Investments in associates.

5.1.10 Non-controlling interests

The year 2012

Net income attributable to non-controlling interests amounted to EUR 5 million in 2012, compared to EUR 4 million in 2011.

The year 2011

Net income attributable to non-controlling interests amounted to EUR 4 million in 2011, compared to EUR 6 million in 2010.

5.1.11 Discontinued operations

The Television business s long-term strategic partnership agreement with TPV was signed on April 1, 2012. The results related to the Television business are reported under Discontinued operations in the Consolidated statements of income and Consolidated statements of cash flows.

In 2012, the loss from discontinued operations of EUR 31 million was due to the net operational results of the business. The transaction was finalized in the first quarter of 2012.

In 2011, the loss from discontinued operations of EUR 515 million was mainly due to the transaction loss recorded on the sale of our Television business of EUR 353 million (after tax), which included an onerous contract provision for the loss recognized upon signing the agreement with TPV, accruals for the expected costs of disentanglement and value adjustments to assets. In addition, the net operational results of the business were an after-tax loss of EUR 162 million.

For further information, refer to note 5, Discontinued operations and other assets classified as held for sale.

5.1.12 Net income

The year 2012

Net income increased from negative EUR 1,291 million in 2011 to EUR 231 million in 2012. The increase was largely due to EUR 1,299 million higher IFO and EUR 484 million lower costs related to discontinued operations, partly offset by lower results relating to investments in associates of EUR 230 million and higher income tax charges of EUR 25 million.

Net income attributable to shareholders per common share increased from negative EUR 1.36 per common share in 2011 to EUR 0.25 per common share in 2012.

The year 2011

Net income decreased from EUR 1,448 million in 2010 to a negative EUR 1,291 million in 2011. The decrease was largely due to EUR 2,343 million lower IFO and EUR 489 million higher costs related to discontinued operations, partly offset by EUR 214 million lower income tax charges.

Net income attributable to shareholders per common share decreased from EUR 1.53 per common share in 2010 to negative EUR 1.36 per common share in 2011.

5.1.13 Acquisitions and divestments

In 2012, Philips completed one acquisition. Acquisitions in 2012 and previous years led to post-merger integration charges totaling EUR 50 million in 2012: Healthcare EUR 18 million, Consumer Lifestyle EUR 18 million, and Lighting EUR 14 million.

In 2011, Philips completed six acquisitions. Acquisitions in 2011 and previous years resulted to post-merger integration charges totaling EUR 74 million in 2011: Healthcare EUR 17 million, Consumer Lifestyle EUR 45 million, and Lighting EUR 12 million.

For further information, refer to note 7, Acquisitions and divestments.

Acquisitions

In 2012, Philips completed the acquisition of Indal. This acquisition fits in with Philips ambition to grow its presence in professional lighting solutions, creating a platform to expand its capabilities to deliver lighting solutions and lead the transition to energy-efficient LED-based lighting applications.

In 2011, we completed six acquisitions. Healthcare acquisitions included Sectra, AllParts Medical and Dameca. Within Consumer Lifestyle, Philips completed the acquisition of Preethi and Povos. Within Lighting, Philips acquired Optimum Lighting.

In 2010, we completed eleven acquisitions. Healthcare acquisitions included Somnolyzer, Tesco, Apex, CDP Medical, Wheb Sistemas and medSage Technologies. Within Lighting, Philips completed the acquisitions of Luceplan, Burton, Street Lighting Controls from Amplex A/S and NCW. Within Consumer Lifestyle, Philips acquired Discus.

Divestments

During 2012, Philips completed several divestments of business activities, namely the Television business (for further information see note 5, Discontinued operations and other assets classified as held for sale), certain Lighting manufacturing activities, Speech Processing activities and certain Healthcare service activities. The Speech Processing activities were sold to Invest AG, in line with our strategy.

In 2012, Philips agreed to extend its partnership with Sara Lee Corp (Sara Lee) to drive growth in the global coffee market. Under a new exclusive partnership framework, which will run through to 2020, Philips will be the exclusive Senseo consumer appliance manufacturer and distributor for the duration of the agreement. As part of the agreement, Philips divested its 50% ownership right in the Senseo trademark to Sara Lee.

In 2011, Philips completed several divestments of which Assembléon was the most significant. Philips sold 80% of the shares in Assembléon to H2 Equity Partners, an Amsterdam-based private equity firm, for a consideration of EUR 14 million.

In 2010, Philips completed several divestments of which the sale of 9.4% of the shares in TPV Technology Ltd (TPV) was the most significant. The TPV shares were sold to CEIC Ltd., a Hong Kong-based technology company, for a cash consideration of EUR 98 million.

For details, please refer to note 7, Acquisitions and divestments.

5.1.14 Performance by geographic cluster

The year 2012

In 2012, sales grew 4% on a comparable basis (10% nominally), driven by growth in Healthcare, notably in growth geographies.

Comparable sales growth by geographic cluster[1)]

in %

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

Sales in mature geographies were EUR 1,059 million higher than in 2011, or 1% higher on a comparable basis. Sales in Western Europe were impacted by the macroeconomic developments, resulting in a 3% decline in comparable sales, attributable to all sectors. On a nominal basis, sales in Western Europe were largely unchanged from the prior year, driven by the acquisition of Indal in Lighting. Sales in North America were EUR 694 million higher, or 2% higher on a comparable basis, driven by single-digit growth in all sectors. Both nominal and comparable sales in other mature geographies showed strong growth. Comparable sales in other mature geographies double-digit growth in all sectors.

In growth geographies, sales grew by EUR 1,150 million, or 10% on a comparable basis, driven by double-digit growth at Healthcare. In China, Healthcare and Lighting recorded solid double-digit nominal and comparable growth. Sales in Russia also showed double-digit growth, attributable to strong sales performance at Consumer Lifestyle and Healthcare.

Sales per geographic cluster

in millions of euros

The year 2011

In 2011, sales grew 4% on a comparable basis (1% nominally), driven by growth in Healthcare and Lighting, notably in growth geographies.

Sales in mature geographies were EUR 247 million lower than in 2010, but 1% higher on a comparable basis. Sales in Western Europe were impacted by the macroeconomic developments, resulting in lower nominal sales for all sectors, particularly in the fourth quarter. Lighting sales in Western Europe showed a slight increase on a comparable basis. Sales in North America showed a slight decline from 2010 nominally, while on a comparable basis they were slightly higher than in 2010, driven by single-digit growth at Healthcare and Lighting. Both nominal and comparable sales in other mature geographies showed strong growth. Comparable sales in other mature geographies grew by double-digits at Lighting and Consumer Lifestyle, and by mid single-digit at Healthcare.

In growth geographies, sales grew by EUR 539 million, or 11% on a comparable basis, driven by double-digit growth in all sectors, notably Healthcare (15%). In China, Healthcare and Consumer Lifestyle recorded solid double-digit nominal and comparable growth. Sales in Russia also showed double-digit growth, attributable to strong sales performance at Lighting and Healthcare.

5.1.15 Cash flows provided by continuing operations

The year 2012

Cash flows from operating activities

Net cash flow from operating activities amounted to EUR 2,198 million in 2012, compared to EUR 768 million in 2011. The year-on-year improvement was largely attributable to lower working capital outflows, mainly related to accounts payable, as well as higher cash earnings. The increase in other current liabilities includes a payable of EUR 509 million related to the European Commission fine for alleged violations of competition rules in the Cathode-Ray Tube (CRT) industry. Excluding the CRT payable, the increase in accounts payable and accrued and other current liabilities was attributable to increased volume from higher sales, while the outflow in 2011 was attributable to a tightening of vendor payments in the operating sectors.

Cash flows from operating activities and net capital expenditures

in millions of euros

Condensed consolidated statements of cash flows for the years ended December 31, 2010, 2011 and 2012 are presented below:

Condensed consolidated cash flow statements[1)]

in millions of euros

	2010	2011	2012
Cash flows from operating activities:			
Net income (loss)	1,448	(1,291)	231
Adjustments to reconcile net income to net cash provided by operating activities	626	2,059	1,967
Net cash provided by operating activities	2,074	768	2,198
Net cash (used for) provided by investing activities	(597)	(1,293)	(912)
Cash flows before financing activities[2)]	1,477	(525)	1,286
Net cash used for financing activities	(97)	(1,790)	(292)
Cash (used for) provided by continuing operations	1,380	(2,315)	994
Net cash (used for) discontinued operations	(22)	(364)	(256)
Effect of changes in exchange rates on cash and cash equivalents	89	(7)	(51)
Total change in cash and cash equivalents	1,447	(2,686)	687

Cash and cash equivalents at the beginning of year	4,386	5,833	3,147
Cash and cash equivalents at the end of year	5,833	3,147	3,834

1) Please refer to section 12.7, Consolidated statements of cash flows, of this report

2) Please refer to chapter 15, Reconciliation of non-GAAP information, of this report

Cash flows from investing activities

2012 cash flows from investing activities resulted in a net outflow of EUR 912 million, attributable to EUR 475 million cash used for net capital expenditures, EUR 259 million used for acquisitions, as well as a EUR 167 million outflow for financial assets, mainly due to loans provided to TPV Technology Limited and the television joint venture TP Vision Holding BV in connection with the divestment of the Televison business (EUR 151 million in aggregate).

2011 cash flows from investing activities resulted in a net outflow of EUR 1,293 million, attributable to EUR 872 million cash used for net capital expenditures and EUR 509 million used for acquisitions, mainly for Povos, Preethi and Sectra. This was partly offset by EUR 106 million proceeds from sale of financial assets and divestment, mainly TCL and Digimarc shares.

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Net capital expenditures

Net capital expenditures totaled EUR 475 million, which was EUR 397 million lower than 2011, mainly due to proceeds received from the sale of the High Tech Campus of EUR 425 million (consisting of a EUR 373 million cash transaction and an amount of EUR 52 million that will be received in future years) and the divestment of our 50% ownership right in the Senseo trademark to Sara Lee for EUR 170 million. Excluding these impacts, higher investments were visible in all sectors, notably additional growth-focused investments in Lighting.

Cash flows from acquisitions and financial assets, divestments and derivatives

in millions of euros

Acquisitions and financial assets

The net cash impact of acquisitions of businesses and financial assets in 2012 was a total of EUR 426 million, mainly related to the acquisition of Indal. The EUR 167 million outflow for financial assets mainly relates to loans provided to TPV Technology Limited and the television joint venture TP Vision Holding BV in connection with the divestment of the Television business (EUR 151 million in aggregate).

The net cash impact of acquisitions of businesses and financial assets in 2011 was a total of EUR 552 million, mainly related to the acquisitions for Povos, Preethi and Sectra.

Divestments and derivatives

Cash proceeds of EUR 36 million were received from divestments, mainly of non-strategic businesses within Consumer Lifestyle and Healthcare**.** Cash flows from derivatives and securities led to a net cash outflow of EUR 47 million.

In 2011, cash proceeds of EUR 106 million were received from divestments, including EUR 69 million from the sale of remaining shares in TCL, as well as divestments of non-strategic businesses within Consumer Lifestyle and Healthcare. Cash flows from derivatives and securities led to a net cash inflow of EUR 25 million.

Cash flows from financing activities

Net cash used for financing activities in 2012 was EUR 292 million. Philips shareholders were given EUR 687 million in the form of a dividend of which cash dividend amounted to EUR 255 million. The net impact of changes in debt was an increase of EUR 731 million, including the issuance of USD 1.5 billion in bonds, partially offset by the early redemption of a USD 500 million bond. Additionally, net cash outflows for share buyback and share delivery totaled EUR 768 million.

Net cash used for financing activities in 2011 was EUR 1,790 million. Philips shareholders were given EUR 711 million in the form of a dividend of which cash dividend amounted to EUR 259 million. The net impact of changes in debt was a decrease of EUR 860 million, including the redemption of a EUR 750 million bond, a USD 350 million bond and other debts totaling EUR 1,314 million, partially offset by the drawdown of a EUR 200 million committed facility and other new long-term borrowing totaling EUR 454 million. Additionally, net cash outflows for share buyback and share delivery totaled EUR 671 million.

The year 2011

Cash flows from operating activities

Net cash flow from operating activities amounted to EUR 768 million in 2011, compared to EUR 2,074 million in 2010. The year-on-year decline was largely attributable to lower cash earnings and higher working capital outflow, mainly related to accounts payable, partly offset by lower inventories and an increase in provisions. The accounts payable outflow was mainly due to the tightening of vendor payments in the operating sectors, as well as the timing of taxes payable.

Cash flows from investing activities

2011 cash flows from investing activities resulted in a net outflow of EUR 1,293 million, attributable to EUR 872 million cash used for net capital expenditures and EUR 552 million used for acquisitions, mainly for Povos, Preethi and Sectra. This was partly offset by EUR 106 million proceeds from sale of financial assets and divestment, mainly TCL and Digimarc shares.

2010 cash flows from investing activities resulted in a net outflow of EUR 597 million, attributable to EUR 716 million cash used for net capital expenditures and EUR 241 million used for acquisitions, mainly for Discus, NCW and medSage Technologies. This was partly offset by EUR 385 million proceeds from divestment, including the sale of 9.4% of the shares in TPV and the redemption of the TPV and CBAY convertible bonds.

Net capital expenditures

Net capital expenditures totaled EUR 872 million, which was EUR 156 million higher than 2010. Higher investments were visible in all sectors, notably additional growth-focused investments in Healthcare.

Acquisitions

Net cash impact of acquisitions in 2011 was a total of EUR 552 million, mainly related to the acquisitions for Povos, Preethi and Sectra.

In 2010, a total of EUR 241 million cash was used for acquisitions, mainly Discus, NCW and medSage Technologies.

Divestments and derivatives

Cash proceeds of EUR 106 million were received from divestments, mainly attributable to EUR 69 million for the sale of remaining shares in TCL, as well as divestments of non-strategic businesses within Consumer Lifestyle and Healthcare**.** Cash flows from derivatives and securities led to a net cash inflow of EUR 26 million.

In 2010, cash proceeds of EUR 385 million were received from divestments, including EUR 98 million from the sale of 9.4% shares in TPV, EUR 165 million and EUR 74 million from the redemption of the TPV and CBAY convertible bonds respectively. The transaction related to the sale of the remaining NXP shares to Philips UK pension fund which was cash-neutral. Net cash flows used for derivatives led to a EUR 25 million net outflow.

Cash flows from financing activities

Net cash used for financing activities in 2011 was EUR 1,790 million. Philips   shareholders were paid EUR 711 million in the form of a dividend of which cash dividend amounted to EUR 259 million. The net impact of changes in debt was a decrease of EUR 860 million, including the redemption of a EUR 750 million bond, a USD 350 million bond and other debts totaling EUR 1,314 million, partially offset by the drawdown of EUR 200 million committed facility and other new long-term borrowing totaling EUR 454 million. Additionally, net cash outflows for share buyback and share delivery totaled EUR 671 million.

Net cash used for financing activities in 2010 was EUR 97 million. Philips   shareholders were paid EUR 650 million in the form of a dividend of which cash dividend amounted to EUR 296 million. The net impact of changes in debt was an increase of EUR 134 million, including a EUR 212 million increase from finance lease and bank loans, partially offset by repayments on short-term debts and other long-term debt amounting to EUR 78 million. Additionally, net cash inflows for share delivery totaled EUR 65 million.

5.1.16 Cash flows from discontinued operations

The year 2012

In 2012, EUR 256 million cash was used by discontinued operations. This was attributable to the operating cash outflows of the Television business of EUR 296 million and a cash inflow from investing activities of EUR 40 million.

In 2011, EUR 364 million cash was used by discontinued operations. This was attributable to the operating cash outflows of the Television business of EUR 270 million and cash outflow to investing activities of EUR 94 million.

The year 2011

In 2011, EUR 364 million cash was used by discontinued operations, attributable to the operating cash flows of the Television business of EUR 270 million and cash flow to investing activities of EUR 94 million.

In 2010, EUR 22 million cash was used by discontinued operations, attributable to cash flow to investing activities of EUR 56 million of the Television business and partially offset by EUR 34 million of operating cash flows.

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5.1.17 Financing

The year 2012

Condensed consolidated balance sheets for the years 2010, 2011 and 2012 are presented below:

Condensed consolidated balance sheet information[1)]

in millions of euros

	2010	2011	2012
Intangible assets	12,233	11,012	10,679
Property, plant and equipment	3,145	3,014	2,959
Inventories	3,865	3,625	3,495
Receivables	4,947	5,117	4,858
Assets held for sale	120	551	43
Other assets	2,567	2,929	3,211
Payables	(6,977)	(6,563)	(6,210)
Provisions	(2,394)	(2,694)	(2,969)
Liabilities directly associated with assets held for sale		(61)	(27)
Other liabilities	(3,628)	(3,867)	(4,165)
	13,878	13,063	11,874
Cash and cash equivalents	5,833	3,147	3,834
Debt	(4,658)	(3,860)	(4,534)
Net cash (debt)	1,175	(713)	(700)
Non-controlling interests	(46)	(34)	(34)
Shareholders equity	(15,007)	(12,316)	(11,140)
	(13,878)	(13,063)	(11,874)

1) Please refer to section 12.6, Consolidated balance sheets, of this report

5.1.18 Cash and cash equivalents

The year 2012

In 2012, cash and cash equivalents increased by EUR 687 million to EUR 3,834 million at year-end. The increase was mainly attributable to cash inflows from operations amounting to EUR 2,198 million and EUR 731 million from increases in debt. This was partly offset by a EUR 768 million outflow for treasury share transactions, an outflow on net capital expenditures of EUR 475 million, a EUR 426 million outflow for acquisitions of businesses and financial assets, a EUR 255 million outflow for the cash dividend payout, and a EUR 256 million outflow related to discontinued operations.

In 2011, cash and cash equivalents decreased by EUR 2,686 million to EUR 3,147 million at year-end. The decrease was mainly attributable to an outflow on net capital expenditures of EUR 872 million, a EUR 860 million decrease in debt, a EUR 671 million outflow for treasury share transactions, a EUR 552 million outflow for acquisitions of businesses and financial assets, and a EUR 259 million outflow for the cash dividend payout. This was partly offset by cash inflows from operations amounting to EUR 768 million, EUR 106 million in proceeds from divestments, including EUR 87 million from the sale of stakes.

Cash balance movements

in millions of euros

1) Includes proceeds from divestment of CL Speech Processing business
2) Please refer to chapter 15, Reconciliation of non-GAAP information, of this report
3) Includes cash inflow for derivatives, partly offset by unfavorable currency effect
4) Acquisitions of businesses and financial assets include the acquisitions of Indal and the venture with TPV

The year 2011

In 2011, cash and cash equivalents decreased by EUR 2,686 million to EUR 3,147 million at year-end. The decrease was mainly attributable to an outflow on net capital expenditures of EUR 872 million, a EUR 860 million decrease in debt, a EUR 671 million outflow for treasury share transactions, a EUR 552 million outflow for acquisitions of businesses and financial assets, and a EUR 259 million outflow for the cash dividend payout. This was partly offset by cash inflows from operations amounting to EUR 768 million, EUR 106 million in proceeds from divestments, including EUR 87 million from the sale of stakes.

In 2010, cash and cash equivalents increased by EUR 1,447 million to EUR 5,833 million at year-end. Cash inflow from operations amounted to EUR 2,074 million, a total outflow on net capital expenditure of EUR 716 million, and there was EUR 385 million proceeds from divestments including EUR 268 million from the sale of stakes. This was partly offset by an outflow of EUR 296 million related to the cash dividend payout, EUR 241 million for acquisitions and favorable currency translation effects of EUR 89 million.

5.1.19 Debt position

The year 2012

Total debt outstanding at the end of 2012 was EUR 4,534 million, compared with EUR 3,860 million at the end of 2011.

Changes in debt

in millions of euros

	2010	2011	2012
New borrowings	(212)	(454)	(1,361)
Repayments	78	1,314	630
Consolidation and currency effects	(257)	(62)	57
Total changes in debt	(391)	798	(674)

In 2012, total debt increased by EUR 674 million. New borrowings of EUR 1,361 million included the issuance of USD 1.5 billion in bonds. Repayment of EUR 630 million included early redemption of a USD 500 million bond. Other changes resulting from consolidation and currency effects led to a decrease of EUR 57 million.

In 2011, total debt decreased by EUR 798 million. The repayment of EUR 1,314 million included redemptions of a EUR 750 million bond, a USD 350 million bond, and EUR 217 million repayment of short-term debt. New borrowing and finance leases amounted to EUR 454 million. Other changes resulting from consolidation and currency effects led to an increase of EUR 62 million.

Long-term debt as a proportion of the total debt stood at 82% at the end of 2012 with an average remaining term of 12.7 years, compared to 85% and 10.4 years at the end of 2011.

For further information, please refer to note 19, Long-term debt and short-term debt.

The year 2011

Total debt outstanding at the end of 2011 was EUR 3,860 million, compared with EUR 4,658 million at the end of 2010.

In 2011, total debt decreased by EUR 798 million. The repayment of EUR 1,314 million included redemptions of a EUR 750 million bond, a USD 350 million bond, and EUR 217 million repayment in short-term debt. New borrowing and finance leases amounted to EUR 454 million. Other changes resulting from consolidation and currency effects led to an increase of EUR 62 million.

In 2010, total debt increased by EUR 391 million. The increase in borrowings including finance leases was EUR 212 million. Repayments under finance leases amounted to EUR 50 million, while EUR 28 million was used to reduce other long-term debt. Other changes resulting from consolidation and currency effects led to an increase of EUR 257 million.

Long-term debt as a proportion of the total debt stood at 85% at the end of 2011 with an average remaining term of 10.4 years, compared to 60% at the end of 2010.

For further information, please refer to note 19, Long-term debt and short-term debt.

5.1.20 Net debt to group equity

The year 2012

Philips ended 2012 in a net debt position (cash and cash equivalents, net of debt) of EUR 700 million, compared to a net debt position of EUR 713 million at the end of 2011.

Net debt (cash) to group equity[1)]

in billions of euros

[1)] For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

[2)] Shareholders equity and non-controlling interests

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The year 2011

Philips ended 2011 in a net debt position (cash and cash equivalents, net of debt) of EUR 713 million, compared to a net cash position of EUR 1,175 million at the end of 2010.

5.1.21 Shareholders equity

The year 2012

Shareholders equity decreased by EUR 1,176 million in 2012 to EUR 11,140 million at December 31, 2012. The decrease was mainly as a result of EUR 816 million related to the purchase of treasury shares and EUR 406 million losses related to pension plans, partially offset by EUR 231 million net income. The dividend payment to shareholders in 2012 reduced equity by EUR 259 million. The decrease was partially offset by a EUR 50 million increase related to the delivery of treasury shares and a EUR 84 million increase in share premium due to share-based compensation plans.

Shareholders equity decreased by EUR 2,691 million in 2011 to EUR 12,316 million at December 31, 2011. The decrease was mainly as a result of a EUR 1,291 million net loss and EUR 447 million losses related to pension plans, as well as EUR 751 million related to the purchase of treasury shares. The dividend payment to shareholders in 2011 reduced equity by EUR 263 million. The decrease was partially offset by a EUR 46 million increase related to the delivery of treasury shares and a EUR 56 million increase in share premium due to share-based compensation plans.

The number of outstanding common shares of Royal Philips Electronics at December 31, 2012 was 915 million (2011: 926 million).

At the end of 2012, the Company held 28.7 million shares in treasury to cover the future delivery of shares (2011: 33.6 million shares). This was in connection with the 52.3 million rights outstanding at the end of 2012 (2011: 47.1 million rights) under the Company s long-term incentive plan and convertible personnel debentures. At the end of 2012, the Company held 13.8 million shares for cancellation (2011: 49.3 million shares).

The year 2011

Shareholders equity decreased by EUR 2,691 million in 2011 to EUR 12,316 million at December 31, 2011. The decrease was mainly as a result of a EUR 1,291 million lower net income and EUR 447 million actuarial losses related to pension plans, as well as EUR 751 million related to the purchase of treasury shares. The dividend payment to shareholders in 2011 reduced equity by EUR 263 million. The decrease was partially offset by a EUR 102 million increase related to delivery of treasury shares and net share-based compensation plans.

Shareholders equity increased by EUR 447 million in 2010 to EUR 15,007 million at December 31, 2010. The increase was mainly as a result of a EUR 626 million improvement within total comprehensive income. The dividend payment to shareholders in 2010 reduced equity by EUR 304 million. The decrease was partially offset by a EUR 111 million increase related to delivery of treasury shares and net share-based compensation plans.

The number of outstanding common shares of Royal Philips Electronics at December 31, 2011 was 926 million (2010: 947 million).

At the end of 2011, the Company held 33.6 million shares in treasury to cover the future delivery of shares (2010: 37.7 million shares). This was in connection with the 47.1 million rights outstanding at the end of 2011 (2010: 54.9 million rights) under the Company s long-term incentive plan and convertible personnel debentures. At the end of 2011, the Company held 49.3 million shares for cancellation (2010: 1.9 million shares).

5.1.22 Liquidity position

Including the Company s net debt (cash) position (cash and cash equivalents, net of debt), listed available-for-sale financial assets, as well as its EUR 1.8 billion committed revolving credit facility, the Company had access to net available liquid resources of EUR 1,220 million as of December 31, 2012, compared to EUR 2,597 million one year earlier.

Liquidity position

in millions of euros

	2010	2011	2012
Cash and cash equivalents	5,833	3,147	3,834
Committed revolving credit facility/ CP program/Bilateral loan	2,000	3,200	1,800
Liquidity	7,833	6,347	5,634
Available-for-sale financial assets at fair value	270	110	120
Short-term debt	(1,840)	(582)	(809)
Long-term debt	(2,818)	(3,278)	(3,725)
Net available liquidity resources	3,445	2,597	1,220

The fair value of the Company s available-for-sale financial assets amounted to EUR 120 million.

Philips has a EUR 1.8 billion committed revolving credit facility that can be used for general corporate purposes and as a backstop of its commercial paper program. In January 2013, the EUR 1.8 billion facility was extended by 2 years until February 18, 2018. The commercial paper program amounts to USD 2.5 billion, under which Philips can issue commercial paper up to 364 days in tenor, both in the US and in Europe, in any major freely convertible currency. There is a panel of banks, in Europe and in the US, which service the program. The interest is at market rates prevailing at the time of issuance of the commercial paper. There is no collateral requirement in the commercial paper program. Also, there are no limitations on Philips use of the program. As at December 31, 2012, Philips did not have any loans outstanding under these facilities.

Philips existing long-term debt is rated A3 (with negative outlook) by Moody s and A- (with negative outlook) by Standard & Poor s. It is Philips objective to manage its financial ratios to be in line with an A3/A- rating. There is no assurance that Philips will be able to achieve this goal. Ratings are subject to change at any time. Outstanding long-term bonds and credit facilities do not have a repetitive material adverse change clause, financial covenants or credit-rating-related acceleration possibilities.

As at December 31, 2012, Philips had total cash and cash equivalents of EUR 3,834 million. Philips pools cash from subsidiaries to the extent legally and economically feasible. Cash not pooled remains available for local operational or investment needs. Philips had a total gross debt position of EUR 4,534 million at year-end 2012.

Philips believes its current working capital is sufficient to meet our present working capital requirements.

5.1.23 Cash obligations

Contractual cash obligations

Presented below is a summary of the Group s contractual cash obligations and commitments at December 31, 2012.

Contractual cash obligations at December 31, 2012

in millions of euros[1)]

		payments due by period			
	total	**less than 1 year**	**1-3 years**	**3-5 years**	**after 5 years**
Long-term debt[2)]	3,733	186	253	2	3,292
Finance lease obligations	298	73	97	40	88
Short-term debt	558	558			
Operating leases	1,219	240	368	236	375
Derivative liabilities	544	138	143	138	125
Interest on debt[3)]	2,802	201	376	360	1,865
Purchase obligations[4)]	289	133	105	36	15
Trade and other payables	2,839	2,839			
	12,282	4,368	1,342	812	5,760

1) Data in this table are undiscounted
2) Long-term debt includes short-term portion of long-term debt and excludes finance lease obligations
3) Approximately 28% of the debt bears interest at a floating rate. The majority of the interest payments on variable interest rate loans in the table above reflect market forward interest rates at the period end and these amounts may change as the market interest rate changes

4) Philips has commitments related to the ordinary course of business which in general relate to contracts and purchase order commitments for less than 12 months. In the table, only the commitments for multiple years are presented, including their short-term portion

Philips has no material commitments for capital expenditures.

Additionally, Philips has a number of commercial agreements, such as supply agreements, which provide that certain penalties may be charged to the Company if it does not fulfill its commitments.

Certain Philips suppliers factor their trade receivables from Philips with third parties through supplier finance arrangements. At December 31, 2012 approximately EUR 310 million of the Philips accounts payables were known to have been sold onward under such arrangements whereby Philips confirms invoices. Philips continues to recognize these liabilities as trade payables and will settle the liabilities in line with the original payment terms of the related invoices.

Other cash commitments

The Company and its subsidiaries sponsor pension plans in many countries in accordance with legal requirements, customs and the local situation in the countries involved. Additionally, certain postretirement benefits are provided in certain countries. The Company is reviewing the funding of pension plans in the Netherlands, the US and

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UK. Refer to note 29, Pensions and other postretirement benefits for a discussion of the plans and expected cash outflows.

The Company had EUR 385 million restructuring-related provisions by the end of 2012, of which EUR 277 million is expected to result in cash outflows in 2013. Refer to note 20, Provisions for details of restructuring provisions and potential cash flow impact for 2012 and further.

A proposal will be submitted to the General Meeting of Shareholders to declare a distribution of EUR 0.75 per common share (up to EUR 685 million), in cash or shares at the option of the shareholder, against the net income for 2012 and the retained earnings of the Company. Further details will be given in the agenda for the General Meeting of Shareholders, to be held on May 3, 2013.

Guarantees

Philips policy is to provide guarantees and other letters of support only in writing. Philips does not provide other forms of support. At the end of 2012, the total fair value of guarantees recognized by Philips in other non-current liabilities amounted to less than EUR 1 million. The following table outlines the total outstanding off-balance sheet credit-related guarantees and business-related guarantees provided by Philips for the benefit of unconsolidated companies and third parties as at December 31, 2011 and 2012.

Expiration per period

in millions of euros

	total amounts committed	less than 1 year	1-5 years	after 5 years
2012				
Business-related guarantees	295	113	114	68
Credit-related guarantees	27	11		16
	322	124	114	84
2011				
Business-related guarantees	297	99	126	72
Credit-related guarantees	39	22		17
	336	121	126	89

5.1.24 Supply management

In the course of 2012, the market prices of energy and raw materials, which together represent between 10% and 15% of our purchasing spend, showed diverse trends in a very volatile market. Prices of most metals dropped from their high levels in 2011 largely as a consequence of the slowdown of the global economy, and especially due to slower Chinese consumption growth. In particular, rare earths the main ingredient of our lighting phosphors dropped steeply from their extremely high price levels in 2011. This was largely the consequence of the deflation of a speculative bubble which was fuelled by export restrictions from China in 2011. In spite of the economic slowdown, energy prices kept their high price levels in 2012, mainly due to market fears and uncertainty from turbulence in various oil-producing countries in 2012. The Procurement organization achieved overall savings of 4.5% in bill-of-material related spend and 6.7% in non-product related spend, resulting in overall savings of 5.2%. Philips did not experience scarcity issues in the market in 2012. Projects geared towards managing such issues became effective during 2012, with the aim of ensuring supply continuity and fostering improved material efficiency. The risk management approach has been revised in order to manage extreme price volatility and supply scarcity in a more rigorous and anticipative manner.

5.2 Social performance

Our businesses provide innovative solutions that address major trends affecting the world the demand for affordable healthcare, the need for greater energy efficiency and the desire for personal well-being.

In 2012, Philips maintained its focus on sustainability. This is rooted in our long-standing belief that sustainability is a key enabler of growth and offers opportunities to innovate our way out of the economic crisis. Therefore, sustainability is an integral part of Philips vision and strategy.

5.2.1 Improving people s lives

The creation of Philips products and solutions that directly support the curative or preventive side of people s health was one of the key objectives of our EcoVision5 program with a target of 500 million lives improved in 2015. By year-end 2012, we were already at a level of 570 million lives, driven by our Healthcare sector.

With the renewal of our company vision in 2012 we have extended this approach with our well-being products that help people live a healthy life, as well as our Green Products that contribute to a healthy ecosystem. Our goal is to improve the lives of 3 billion people a year by 2025. For the year 2012 we have established our total baseline at 1.7 billion people a year. More information on this metric can be found in chapter 14, Sustainability statements, of this report.

5.2.2 Employee engagement

At Philips, we believe that employee engagement is an important measure that helps us to manage and develop our human capital and stimulate business growth through our people. Our 2011 Employee Engagement Survey (EES) showed that our overall engagement scores at Philips were in line with external high performance norms.

Employee Engagement Index

in %

1) Based on 60 pulse surveys conducted in 2012

In 2012 we announced our intention to move from an annual measurement of EES data to a bi-annual basis to allow more time for teams to analyze results and enact improvement actions, as well as to create an opportunity to review the way we approach engagement. Through these measures, we hope to identify how we can improve the link between the high levels of employee engagement that we are achieving and improved business results.

We remain committed to creating a great place to work for our employees in line with our corporate vision. We will use the additional time before the next EES to drive existing action plans and, where applicable, begin new actions designed to improve employee engagement. Through our internal social media tool Connect Us and an open SharePoint site we provide forums for managers and employees to share best practices and ask questions on the topic of engagement.

We also continue to use pulse surveys to measure engagement levels in certain teams such as new acquisitions or groups going through significant changes. While this does not provide a statistical comparison to the total organization results of the past, it does provide insight into progress being made for these teams. In 2012 we deployed over 60 pulse surveys touching nearly 2,000 employees. In previous years over 80% of the Philips employees participated in the EES.

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In 2013 we will deploy our renewed approach to employee engagement with a focus on developing an engaging, high-performance work environment**.** Individual actions around engagement are crucial to drive our performance culture forward. This will help us to continue to create a working environment that inspires individuals and stimulates business growth.

5.2.3 Diversity and inclusion

During 2012, we continued to focus on increasing the opportunities for women and other under-represented groups throughout the organization, and on developing a diverse talent pipeline, as we truly believe that diversity enables us to better serve our customers. As a result, we made progress towards the diversity targets of Philips executive population.

Workforce diversity

in %

[1] Left to right: 2010, 2011 and 2012

The share of female executives at the end of 2012 was 14%, which was 1% above 2011, but 1% below our 15% target for 2012. However, women made up 22% of all new executive promotions, a clear indication of the positive impact of the inclusive talent management approach that supports the development of diverse talents. While our 2012 gender diversity targets were not achieved, we have increased our efforts and are getting the right measures in place to drive change longer term, as evidenced by the one-third increase in the share of female executives over the last two years.

New hire diversity

in %

[1] Left to right: 2010, 2011 and 2012

In 2012, Philips employed 36% females, on par with 2011.

With the appointment of Deborah DiSanzo as CEO of Philips Healthcare, Philips now has two women on its Executive Committee. The nomination in 2012 of Neelam Dhawan, Managing Director of HP India, as the second female member of the Supervisory Board, also re-confirms the company s ongoing commitment to diversity.

In line with the growing importance of BRIC countries for Philips business, the share of executives with Brazilian, Russian, Indian and Chinese nationality increased from 8% in 2011 to 9% in 2012, one percentage point below the 2012 target. Overall, the 535 Philips Executives represent 33 different nationalities.

Employees per age category

in %

1) Left to right: 2010, 2011 and 2012

In 2012, employee turnover amounted to 14%, an increase compared to 2011 caused by the various restructuring initiatives mainly at Lighting and IG&S.

Employee turnover

in %

	2011	2012
Female	13	14
Male	10	13
Philips Group	11	14

Exit diversity

in %

5.2.4 Employment

The year 2012

The total number of Philips Group employees was 118,087 at the end of 2012, compared to 121,888 at the end of 2011. Approximately 42% were employed in the Lighting sector, due to the continued vertical integration in this business. Some 32% were employed in the Healthcare sector and approximately 16% in the Consumer Lifestyle sector.

Employees per sector 2012

in FTEs at year-end

Compared to 2011, the number of employees in continuing operations decreased by approximately 3,800. This decrease reflects a reduction of 3,686 employees, mainly related to the company s overhead reduction program, primarily at Lighting and IG&S. It also reflects the departure of 1,024 employees, mainly due to the industrial footprint reduction at Lighting, and the addition of 909 employees from acquisitions (mainly Indal).

Approximately 52% of the Philips workforce is located in mature geographies, and about 48% in growth geographies. In 2012, the number of employees in mature geographies decreased by 3,951, as the additional headcount from acquisitions was more than offset by reductions relating to the company s overhead reduction program and the industrial footprint reduction in Lighting. Growth geographies headcount increased by 150, primarily in the growth businesses in Consumer Lifestyle.

Employees per sector

in FTEs at year-end

	2010	2011	2012
Healthcare	36,253	37,955	37,460
Consumer Lifestyle	14,095	18,291	18,911
Lighting	53,888	53,168	50,224
Innovation, Group & Services	11,929	12,474	11,492
Continuing operations	116,165	121,888	118,087
Discontinued operations	3,610	3,353	
	119,775	125,241	118,087

Employees per geographic cluster

in FTEs at year-end

	2010	2011	2012
Western Europe	33,557	33,515	31,562
North America	27,881	28,249	26,122
Other mature geographies	3,045	3,234	3,363
Total mature geographies	64,483	64,998	61,047
Growth geographies	51,682	56,890	57,040
Continuing operations	116,165	121,888	118,087
Discontinued operations	3,610	3,353	
	119,775	125,241	118,087

Employment

in FTEs

	2010	2011	2012
Position at beginning of year	116,153	119,775	125,241
Consolidation changes:			
acquisitions	1,457	4,759	909
divestments	(307)	(479)	(1,024)
comparable changes	3,626	1,443	(3,686)
Divestment and other changes in discontinued operations	(1,154)	(257)	(3,353)
Position at year-end	119,775	125,241	118,087
of which:			
continuing operations	116,165	121,888	118,087
discontinued operations	3,610	3,353	

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The year 2011

The total number of Philips Group employees was 121,888 at the end of 2011, compared to 116,165 at the end of 2010. Approximately 44% were employed in the Lighting sector, due to the continued vertical integration in this business. Some 31% were employed in the Healthcare sector and approximately 15% in the Consumer Lifestyle sector.

Compared to 2010, the number of employees increased by 5,723. This figure included 4,759 additional employees from acquisitions and reduction of 479 employees via divestments. The remaining increase centered primarily on Healthcare, mainly in North America.

Approximately 53% of the Philips workforce is located in mature geographies, and about 47% in growth geographies. In 2011, the number of employees in mature geographies increased slightly as headcount reduction from organizational restructuring was more than offset by additional headcount from growing businesses within Healthcare. Growth geographies headcount increased by 5,208, mainly as a result of acquisitions in Consumer Lifestyle.

5.2.5 Developing our people

With 2012 being a year of focus on all learning methodologies, including classroom, coaching, mobile learning and on-the-job experience, we recorded over 43,000 enrollments in personal effectiveness and leadership programs available through the Learning Portal, an increase compared to 39,500 in 2011. Some 5,500 employees participated in personal effectiveness workshops delivered across the world by Philips accredited internal facilitators.

Enrollment in functional curricula programs, including Marketing, Finance, IT, Sales, HR, Procurement and Innovation, decreased slightly to 24,000 compared to 25,000 in 2011. Many functional curricula are tied to mandatory learning plans designed to increase our organizational capability. In 2012, we also introduced local market programs with specific training modules for our staff in various geographies, including China, India, Africa and Russia, for which there have been some 13,500 enrollments to date.

number of enrollments

	2008	2009	2010	2011	2012
Core Curriculum programs	10,000	5,500	20,000	39,500	43,000

In 2012, we also introduced a new service getAbstract a comprehensive library of compressed knowledge including over 7,000 relevant business book summaries from leading business authors. getAbstract releases over 50 abstracts each month, ensuring fresh content is always available for users. With the service successfully launched in May 2012 we registered 86,000 downloaded book summaries, in the form of PDF, downloaded to mobile devices or MP3.

The Octagon program concluded in 2012 involved 31 participants who completed eight business projects sponsored by senior business leaders targeting growth geographies, the US and South Africa.

The Accelerate! Leadership Program (ALP) was conducted for over 700 leaders from 40 teams to further embed the Accelerate! mindset and behaviors and develop high performance teams. The Accelerate! Team Performance (ATP) Facilitator Development program, launched in Q3, trained 120 business and HR leaders across Asia, Europe and North America to conduct ATPs and embed cultural modules to increase team effectiveness.

As 2012 was a year of continued focus on leadership development in our key emerging markets, we introduced new programs supporting fast growth in those geographies. The Strategic Thinking and Business Model Creation program run in both Africa and India, contributed to local strategic capability building and commencing developing a granular approach to the next series of strategy initiatives. The China Leadership Accelerate Program , focusing on stimulating innovative thinking and promoting an entrepreneurial culture with customer-centric mindsets, prepared its 29 participants for future general management roles. Designed in collaboration with the leading Indian School of Business, the ALTIUS Leadership Development Program ran in India with the objective to prepare leaders to take up future business leadership roles across geographies and cultural boundaries.

Other programs

In the Netherlands, we have for many years played a pioneering role with our national Vocational Qualification Program (CV) and the Philips Employment Scheme (WGP). The CV project has been running since 2004 and targets employees who know their trade well, but do not have a diploma to prove it. CV provides a solution by awarding these people a recognized qualification. To date, more than 1,750 participants have obtained a qualification that will help them in their future careers.

Via WGP, we offer vulnerable groups of external jobseekers work experience placement, usually combined with some kind of training. Between 2010 and 2012, for example, we trained 10 autistic persons to become (junior) test engineers. As a result, seven found their next job, one proceeded with a mathematics study, and the last two are applying for jobs. In November 2012, after a four month preparation period, Philips started with the next group of nine autistic persons.

5.2.6 Health and Safety

Philips strives for an injury-free and illness-free work environment, with a sharp focus on decreasing the number of injuries. This is defined as a KPI, on which we set yearly targets for the company and our individual sectors.

We regret to report seven fatalities in 2012, of which two were related to a traffic accident in India when two service engineers were returning from a customer visit, one was related to a safety accident in China, and one to a traffic accident whilst commuting in China. One Philips employee passed away after a traffic accident in the Netherlands whilst commuting. In Pakistan, a Philips employee died after a traffic accident on his way to a customer. Lastly, during an environmental audit in Indonesia, a government official suffered cardiac arrest and passed away.

In 2012, we recorded 345 Lost Workday Injuries cases, i.e. occupational injury cases where the injured person is unable to work the day after the injury. This is a significant decrease compared with 2011. The number of Lost Workdays caused by these injuries amounted to 12,630 days. The rate of Lost Workday Injuries decreased to 0.31 per 100 FTEs compared with 0.38 in 2011.

Lost Workday Injuries

per 100 FTEs

	2008	2009	2010	2011	2012
Healthcare	0.27	0.20	0.25	0.20	0.22
Consumer Lifestyle	0.44	0.26	0.26	0.23	0.25
Lighting	1.17	0.76	0.80	0.64	0.45
Innovation, Group & Services	0.12	0.07	0.13	0.04	0.05
Philips Group	0.68	0.44	0.50	0.38	0.31

Healthcare and CL showed an increase in the Lost Workday Injury rate, Lighting recorded a decrease. However, the number of Lost Workday Injury cases at CL and Lighting decreased. At Lighting, a dedicated action program, Safety First, was launched five years ago to drive down injury levels. In 2012, various regional Health & Safety improvement programs were started as well as peer audit programs. Next, we updated our Health & Safety (H&S) policy and further deployed the H&S manual to all sites to help them structurally improve the H&S culture and implemented a monthly reporting process. Safety is fully integrated in the Lean Program.

A number of sites have been recognized for their outstanding safety performance, for example: Philips AVENT, the manufacturing center for Philips parenting and baby products in the UK, has won the Bronze RoSPA safety award. Philips Home Healthcare Solutions in the Philippines won the Best in Rescue and Transfer Relay Award in the Philippines National Industrial Fire Brigade Competition. Philips Lighting Flight Forum has been recognized as the safest warehouse in the Netherlands and Philips Lighting Yizheng won the Guangzhou Green Star Award.

5.2.7 General Business Principles

The Philips General Business Principles (GBP) govern Philips business decisions and actions throughout the world, applying equally to corporate actions and the behavior of individual employees. They incorporate the fundamental principles within Philips for doing business.

The GBP are available in most of the local languages and are an integral part of the labor contracts in virtually all countries where Philips has business activities. Responsibility for compliance with the principles rests primarily with the management of each business. Every country organization and each main production site has a compliance officer. Confirmation of compliance with the GBP is an integral part of the annual

Statement on Business Controls that has to be issued by the management of each business unit. The GBP incorporate a whistleblower policy, standardized complaint reporting and a formal escalation procedure.

The global implementation of the One Philips Ethics hotline seeks to ensure that alleged violations are registered and dealt with consistently within one company-wide system.

To drive the practical deployment of the GBP, a set of directives has been published, which are applicable to all employees. There are also separate directives which apply to specific categories of employees, e.g. the Supply Management Code of Ethics and Financial Code of Ethics. Details can be found at www.philips.com/gbp.

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Ongoing training

The mandatory web-based GBP training, which is designed to reinforce awareness of the need for compliance with the GBP, is available in 23 languages.

More information on the Philips GBP can be found in chapter 7, Risk management, of this report. Results of the monitoring in place are provided in the chapter 14, Sustainability statements, of this report.

5.2.8 Social Investment Programs

As part of our drive to improve the health and well-being of people around the world, our focus on encouraging the next generation to embrace healthy and active lifestyles continued in 2012 with the further expansion and localization of our SimplyHealthy@Schools program. Working together with local schools, communities and non-profit organizations, nearly 1,400 volunteers traveled to over 230 schools in 33 countries, teaching lessons about healthy living and environmental sustainability to over 24,000 children worldwide. In addition, working together with the Singapore Nutrition and Dietetics Association, we rolled out a new and interactive Nutrition module that has helped children all the way from Malaysia to Pakistan understand the importance of a healthy breakfast.

In the United States, the Philips Cares program is a way for employees to support projects that create healthy, sustainable communities that contribute to the success and well-being of future generations. In 2012 alone, some 4,800 employees participated in volunteer opportunities that suited their needs, schedules, and passions. It is through Philips Cares and our charitable partnerships with organizations such as the American Heart Association and the American Red Cross, that Philips and its employees are able to improve the quality of life in their communities today and for tomorrow.

At the end of 2012 we also signed a three year partnership agreement with the Royal Dutch Football Association (KNVB) to support their WorldCoaches program by installing more than 100 solar lighting Light Centers in rural communities throughout Africa and South America. Working together with local communities and the KNVB, the Light Centers will provide safe and functional space for sports and other community activities once the sun goes down.

5.2.9 Stakeholder engagement

Across all our activities we seek to engage stakeholders to gain their feedback on specific areas of our business. Working in partnerships is crucial in delivering on our vision to make the world healthier and more sustainable through innovation. An overview of stakeholders is provided in chapter 14, Sustainability statements, of this report.

The Philips Center for Health and Well-being

The Philips Center for Health and Well-being is a knowledge-sharing forum that provides a focal point to raise the level of discussion on what matters most to citizens and communities. The Center brings together experts for dialogue and debate aimed at overcoming barriers and identifying possible solutions and meaningful innovations that can improve people s lives. It also facilitates research on a range of health and well-being topics.

Philips seeks to address key societal issues by developing solutions relating to Healthcare & Aging, Urbanization and Access to Energy. The Center was launched in December 2009 and amongst others brings together teams of multidisciplinary experts from all over the world to discuss and debate Aging Well, Livable Cities and Mother and Childcare. Participants include NGOs and Academia, such as European Patient Forum, ISOCARP, Harvard School of Public Health, Keio University Tokyo and global experts on each of the respective subjects.

For more information on the work of the Center, go to www.philips-thecenter.org.

Working on global issues

In 2012, Philips participated in two major UN conferences. In June, we contributed to the UN Rio+20 sustainable development conference in Rio de Janeiro, where we shared the triple benefits offered by sustainable solutions, with an emphasis on LED lighting. At Rio+20 The Climate Group launched a report Lighting the Clean Revolution, the rise of LED lighting and what it means for cities . In December we participated in the United Nations Climate Change Conference in Doha, Qatar. We partnered with other leading industry players, governmental organizations, NGOs and several UN entities. We commissioned a report by Ecofys that highlighted the real economics of energy efficiency, called The benefits of energy efficiency: why wait? . The report highlights the relevance and potential of energy efficiency to slash energy bills, reduce public budget deficits, reduce greenhouse gas emissions and stimulate job creation, and will be used further in public stakeholder engagements.

In November 2012, we organized the Philips Innovation Experience which was attended by some 1,500 journalists, customers, scientists, partners and employees. This year s theme was Rethinking solutions for tomorrow s society and demonstrated Philips drive for sustainable innovation to address global challenges like population growth and urbanization, aging population and rising healthcare costs, and growing demands for energy and water and food scarcity.

We firmly believe that these global challenges can only be addressed through Open Innovation and constructive dialogue with all stakeholders involved.

5.2.10 Supplier sustainability

More and more, our products are being created and manufactured in close cooperation with a wide range of business partners, both in the electronics industry and other industries. Philips needs suppliers to share our commitment to sustainability, and not just in the development and manufacturing of products but also in the way they conduct their business. We require suppliers to provide a safe working environment for their workers, to treat workers with respect, and to work in an environmentally sound way. Our programs are designed to engage and support our suppliers on a shared journey towards continuous improvement in supply chain sustainability.

As a leading company in sustainability, Philips will act as a catalyst and support our suppliers in their pursuit of continuous improvement of social and environmental performance. We recognize that this is a huge challenge requiring an industry-wide effort in collaboration with other societal stakeholders. Therefore, we remain active, together with peers in the industry, in the Electronic Industry Citizenship Coalition (EICC) and encourage our strategic suppliers to join the EICC too. We will also continue to seek active cooperation and dialogue with other societal stakeholders including governments and civil society organizations, either directly or through institutions like the EICC, the multi-stakeholder program of the Sustainable Trade Initiative IDH, and the OECD.

Supplier Sustainability Involvement Program

The Philips Supplier Sustainability Involvement Program is our overarching program to help improve the sustainability performance of our suppliers. We create commitment from our suppliers by requiring them to comply with our Regulated Substances List and the Philips Supplier Sustainability Declaration, which we include in all purchasing contracts. The Declaration is based on the EICC code of conduct and we added requirements on Freedom of Association and Collective Bargaining. The topics covered in the Declaration are listed below.

We monitor supplier compliance with the Declaration through a system of regular audits.

2012 supplier audits in risk countries

Philips conducted 159 full-scope audits in 2012, including four joint audits conducted on behalf of Philips and other EICC member companies. On top of this, 65 audits of potential suppliers were performed. Potential suppliers are audited as part of the supplier approval process, and they need to close any zero-tolerance issues before they can start delivering to Philips. The number of audits done this year is lower due to new audit criteria introduced in 2011, which place more focus on capacity building programs to realize structural improvements.

As in previous years, the majority of the audits in 2012 were done in China. The total number of full-scope audits carried out since we started the program in 2005 is now close to 2,000. This number includes repeated audits, since we execute a full-scope audit at our risk suppliers every three years. The audit program covers 90% of our active risk supplier base. Most of the audits done in 2012 were continued-conformance audits, because the majority of our risk suppliers had already undergone an audit in the past.

Accumulative number of initial and continual conformance audits

Distribution of supplier audits by country

Audit findings

We believe it is important to be transparent about the issues we observe during the audits. Therefore we have published a detailed list of identified major non-compliances in our Annual Report since 2010. To track improvements, Philips measures the compliance rate for the identified risk suppliers, i.e. the percentage of risk suppliers that were recently audited and had resolved all major non-compliances. During 2012 we achieved a compliance rate of 75% (2011: 72%).

Please refer to section 14.5, Supplier indicators, of this report for the detailed findings of 2012.

Supplier development and capacity building

Based on many years of experience with the audit program, we know that a combination of audits, capacity building, consequence management and continuous attention from management is crucial to realize structural and lasting changes at supplier production sites. During 2012 we extended our capacity-building initiatives, which are offered to help suppliers improve their practices. Our supplier sustainability experts in China, India and Brazil organized classroom trainings, regularly visited suppliers for on-site consultancy on specific topics, and helped suppliers to train their own workers on topics like occupational health and safety.

We also teamed up with industry peers, nongovernmental organizations and a trade union to work on capacity building at Chinese factories via the IDH Electronics Program. This program was kicked off in 2011 and is an innovative multi-stakeholder initiative sponsored by the Sustainable Trade Initiative (IDH) together with Dell, HP, Philips and civil society organizations. The goal is to improve working conditions for more than 500,000 employees in the electronics sector. In 2012 we continued the implementation phase in China s Pearl River Delta and a total of eight Philips suppliers are now involved in the program.

5.2.11 Conflict minerals: issues further down the chain

Philips is concerned about the situation in the east of the Democratic Republic of the Congo (DRC) where proceeds from the extractives sector are used to finance rebel conflicts in the region. Philips is committed to address this issue through the means and influencing mechanisms available to us, even though we do not directly source minerals from the DRC and mines are typically seven or more tiers removed from our direct suppliers.

During 2012 we worked with 347 priority suppliers to raise awareness and start supply chain investigations to determine the origin of the metals in our products. This resulted in the identification of 127 smelters in our supply chain that were used to process these metals. We encourage all smelters in our supply chain to participate in the EICC-GeSI Conflict Free Smelter program. By publishing this smelter list we have created transparency at deeper levels in our supply chain regarding those actors that we believe hold the key to effectively addressing the concerns around conflict minerals.

In September 2012 the Conflict-Free Tin Initiative was launched, introducing a tightly controlled conflict-free supply chain of tin from a mine in Congo all the way down to an end-product. Philips is one of the industry partners brought together by the Dutch government that initiated this conflict-free sourcing program in eastern DRC. Although this region has a rich supply of minerals, its economy has collapsed due to decades of conflict. In an effort to prevent minerals from being used to finance war, and in response to the US Dodd-Frank Act obligations, many companies worldwide have shied away from purchasing minerals from the DRC, creating a de facto embargo and a collapse of the local economy. Philips, believes that this provides opportunities to positively engage in the DRC and invest in legitimate minerals trade. Therefore, we helped launch the Conflict-Free Tin initiative to catalyze economic growth in the region outside the control of the rebels. In October 2012 an important milestone was reached when the first bags of tagged minerals left the mine. The first end-user products containing this conflict-free tin are expected mid-2013.

We believe that industry collaboration and stakeholder dialogue are important to create impact at deeper levels of our supply chain. Therefore, Philips continued its active contribution to the Extractives Work Group, a joint effort of the EICC and GeSI to positively influence the social and environmental conditions in the metals extractives supply chain. To assist in developing a due diligence standard for conflict minerals, we participated in the multi-stakeholder OECD-hosted pilot for the implementation of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas . We also continued our engagement with relevant stakeholders including the European Parliament, other industry organizations and local as well as international NGOs in Europe and the US to see how we can resolve the issue.

For more details and result of our supplier sustainability program, please refer to section 14.5, Supplier indicators, of this report.

5.3 Environmental performance

EcoVision

Philips has a long sustainability history stretching all the way back to our founding fathers. In 1994 we launched our first program and set sustainability targets for our own operations. In 1998, we launched our first EcoVision program focused on operations and products. We also started to focus on sustainability in our supply chain in 2003. In 2010 we extended our scope further by including the social dimension of products and solutions, which is now reflected in our renewed company vision stating that we strive to make the world healthier and more sustainable through innovation. Our goal is to improve the lives of 3 billion people a year by 2025.

The main elements of the EcoVision program are:

- Green Product sales
- Improving people s lives
- Green Innovation
- Green Operations
- Health & Safety
- Employee Engagement
- Supplier Sustainability

In this environmental performance section an overview is given of the most important environmental parameters of the program. Improving people s lives, Health & Safety, Employee Engagement and Supplier Sustainability are addressed in the Social performance section. Details of the EcoVision parameters can be found in the chapter 14, Sustainability statements, of this report.

5.3.1 Green Innovation

Green Innovation is the Research & Development spend related to the development of new generations of Green Products and Green Technologies. In 2010 we announced plans to invest a cumulative EUR 2 billion in Green Innovation during the coming 5 years. Philips invested some EUR 570 million in Green Innovation in 2012, with the strongest contribution from Lighting.

Green Innovation per sector

in millions of euros

Energy efficiency of products

Energy efficiency is a key Green Focal Area for our Green Products. Our analysis has shown that about 97% of the energy consumed during the use phase of our products is attributable to Lighting products. The remaining 3% is split over Consumer Lifestyle and Healthcare. Therefore, we focus on the energy efficiency of our Lighting products in the calculation. The annual energy consumption per product category is calculated by multiplying the power consumption of a product by the average annual operating hours and the annual pieces sold and then dividing the light output (lumens) by the energy consumed (watts). The average energy efficiency of our total product portfolio improved some 7% in 2012 (17% compared to 2009).

Although LED sales advanced well, demand for conventional lighting remained fairly stable due to the challenging economic environment. Since the number of traditional lamps sold is significantly higher than LEDs, the energy efficiency improvement of the total Lighting portfolio in 2012 was limited. Our target for 2015 is a 50% improvement compared to the 2009 baseline. Further details on this parameter and the methodology can be found in the document Energy efficiency of Philips products at www.philips.com/sustainability.

Closing the material loop

In 2010 we calculated the 2009 baseline for global collection and recycling amounts at around 37,000 tonnes (excluding TV), based on the data retrieved from the WEEE collection schemes and from our own recycling and refurbishment services (mainly Healthcare). The amount of collection and recycling for 2011 (reported in 2012) was calculated at 43,000 tonnes as we noted an increase in recycled Lighting products.

We calculated the amount of recycled materials in our products in 2012 at some 12,000 tonnes (2011: 10,000 tonnes), by focusing on the material streams plastics, aluminum and refurbished products, depending on the relevance in each sector.

Our target is to double the global collection and recycling and the amount of recycled materials in our products by 2015 compared to 2009. Further details on this parameter and the methodology can be found in the document Closing the material loop at www.philips.com/sustainability.

Healthcare

Philips Healthcare develops innovative solutions across the continuum of care in partnership with clinicians and customers to improve patient outcomes, provide better value, and expand access to care. While doing so, we take into account all Green Focal Areas and aim to reduce environmental impact over the total lifecycle. Healthcare investments in Green Innovation in 2012 amounted to EUR 136 million with a focus on energy efficiency and dose reduction. Other areas covered include increased levels of recycled content in our products and closing the materials loop, e.g. through upgrading strategies, parts harvesting and refurbishing programs as well as reducing environmentally relevant substances from our products. The investments reflect the increasing interest that we see in societies across the globe for green hospitals and reduced environmental impact of healthcare. Philips Healthcare actively supports a voluntary industry initiative for improving the energy efficiency of imaging equipment. Moreover, solutions are being developed to support hospitals in identifying and realizing energy efficiency opportunities in their operations.

Consumer Lifestyle

Green Innovation at Consumer Lifestyle amounted to EUR 70 million. The sector continued its work on improving the energy efficiency of its products, closing the materials loop (e.g. by using recycled materials in products and packaging) and the voluntarily phase-out of polyvinyl chloride (PVC), brominated flame retardants (BFR) and Bisphenol A (BPA) from food contact products. In particular, the Personal Care business launched many products which are completely PVC/BFR-free. Overall this has resulted in an increase in Green Product sales at the Personal Care, Domestic Appliances, Health & Wellness and Coffee businesses.

Lighting

At Lighting, we strive to make the world healthier and more sustainable through energy-efficient lighting solutions. In 2012 Lighting invested EUR 325 million to develop products and solutions that address environmental and social challenges. Investments are made to advance the LED revolution, which can substantially reduce carbon dioxide emissions (by switching from inefficient to energy-efficient lighting). Furthermore, Lighting has developed solutions for water purification, solar LEDs for rural and urban locations, and LED solutions for agricultural applications supporting biodiversity.

Philips Group Innovation

Philips Group Innovation invested EUR 38 million in Green Innovations, spread over projects focused on global challenges related to water, air, waste, and energy. Group Innovation deployed the EcoVision portfolio mapping tool in which innovation projects are mapped along the environmental and social dimension to further drive sustainable innovation. One example of a Group Innovation project is related to LED light recipes. Population growth and urbanization is putting a lot of pressure on the planet s ecological system (water, nutrients, fertilizers, herbicides, and pesticides). There is a variety of potential solutions and initiatives ongoing to fundamentally change the way food is produced, transported and monitored. We contributed through, for example, innovations on LED light recipes in greenhouses, city farm initiatives, light recipes to enhance plant resistance to disease, and lighting to increase nutritious value and shelf life in supermarkets.

5.3.2 Green Product sales

In 2012, sales from Green Products increased from EUR 8.8 billion in 2011 to EUR 11.3 billion, or 45% of sales, on track to reach the target of 50% in 2015.

All sectors contributed to the growth in Green Product sales. Healthcare achieved the highest Green Product nominal sales growth (36%), followed by Lighting (26%) and Consumer Lifestyle (20%).

The Philips EcoDesign process aims to create products that have significantly less impact on the environment during their whole lifecycle. Overall, the most significant improvements have been realized in our energy efficiency Green Focal Area, an important objective of our EcoVision program, although there was also growing attention for recyclability and hazardous substances in all sectors in 2012.

Green Product sales per sector

in millions of euros

New Green Products from each sector include the following examples.

Healthcare

During 2012, Healthcare expanded the Green Product portfolio with 16 new products to improve patient outcomes, provide better value, and expand access to care, while reducing environmental impact. All Business Groups in the sector contributed to the increase. Imaging Systems continued to expand the fleet of CT systems with dose reduction and MRI systems with PowerSave, an energy efficient feature. Philips MRI has been recognized by COCIR as the front runner in the industry for energy efficient MRI. In addition, Ultrasound and CT systems with lower weight and energy usage were released. Green Innovations from Patient Care & Clinical Informatics include the HeartStart FR3 Defibrillator which has eliminated a number of environmentally relevant substances and is 25% lighter in weight than its predecessor. At Home Healthcare Solutions, the sleep therapy products REMStar and BIPAP A30 have considerably lower energy use and packaging weight than their predecessor.

Consumer Lifestyle

Consumer Lifestyle has always focused strongly on energy management and the avoidance of substances of concern in products, in addition to their efforts to close the materials loop. The sector continued with the introduction of products free of polyvinyl chloride (PVC) and brominated flame retardants (BFR). In 2012, Consumer Lifestyle introduced the Home Cooker, an appliance that not only provides an extra pair of hands in the kitchen and helps to easily create a homemade meal, but is able to do so while consuming less energy than conventional cooking.

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Lighting

In 2012 Philips introduced the next generation shop accent lighting, namely CDM Evolution. The Evolution lamp is 10% more-energy efficient than its predecessor (CDM Elite). A Philips MASTERColour Evolution lamp is now on average 30% more energy-efficient than a CDM standard lamp introduced in 1994, and 10-20% more energy-efficient that the average competition. The Evolution lamp is also much longer-lasting. In the past average lifetime was around 12,000 hours. The Evolution range extends lifetime beyond 20,000 hours, almost halving the need for lamp replacement and therefore helping to reduce waste levels.

5.3.3 Green Operations

The Green Operations program focuses on the main contributors to climate change, recycling of waste, reduction of water consumption and reduction of emissions of restricted and hazardous substances.

Full details, can be found in chapter 14, Sustainability statements, of this report.

Carbon footprint and energy efficiency

In 2012, we achieved our EcoVision4 carbon reduction target as our operational CO_2 emissions decreased 25% compared to 2007, the baseline year. We were able to achieve this significant reduction for a number of reasons, including our ongoing energy efficiency improvement program, Green logistics, our changing industrial footprint, and the increase in purchased electricity from renewable sources. These were, however, partly offset by increased CO_2 emissions from manufacturing (+1% compared to 2011), due to a significant increase in reporting sites (acquisitions).

In 2012, CO_2 emissions from non-industrial sites decreased 9%, partly because of our continued focus on the most efficient use of facility space, for instance with our Work Place Innovation program (which enables flex-working), but also due to the increased share of purchased electricity from renewable sources.

Due to a stringent travel policy, total emissions from business travel decreased 15% in 2012. We continue to promote video conferencing as an alternative to travel; as a result air travel is down 24%, saving a total of 38 kilotonnes CO_2 emissions. In 2012, logistics CO_2 emissions decreased 17%, because of the exclusion of the logistic movements related to the TV business, our continued focus on efficient container utilization, reduced mileage in road freight, and the shift from air to sea freight, which is cleaner and more cost-effective.

Our operational energy efficiency improved 7%, from 1.24 terajoules per million euro sales in 2011 to 1.15 terajoules per million euro sales in 2012 as a result of a lower carbon footprint and higher sales.

Operational carbon footprint

in kilotonnes CO_2-equivalent

Ratios relating to carbon emissions and energy use

	2008	2009	2010	2011	2012
Operational CO_2 emissions in kilotonnes CO_2-equivalent	2,111	1,930	1,845	1,771	1,614
Operational CO_2 efficiency in tonnes CO_2-equivalent per million euro sales	80	83	73	70	65
Operational energy use in terajoules	33,831	31,145	32,766	31,402	28,405
Operational energy efficiency in terajoules per million euro sales	1.28	1.34	1.29	1.24	1.15

Operational carbon footprint by Greenhouse Gas Protocol scopes

in kilotonnes CO_2-equivalent

	2008	2009	2010	2011	2012
Scope 1	467	447	441	431	443
Scope 2	673	636	485	427	409
Scope 3	971	847	919	913	762
Philips Group	2,111	1,930	1,845	1,771	1,614

Water

Total water intake in 2012 was 4.9 million m^3, about 12% higher than in 2011. This increase was mainly due to new acquisitions that started to report in 2012, which accounted for 11% of group water consumption in 2012 as well as increased water use at Lighting Lumileds sites. At Consumer Lifestyle the total water consumption went down by 10%, partially due to the divestment of Television activities.

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Lighting represents around 85% of total water usage. In this sector, water is used in manufacturing as well as for domestic purpose. The other sectors use water mainly for domestic purposes.

Water intake

in thousands m^3

	2008	2009	2010	2011	2012
Healthcare	370	363	256	308	421
Consumer Lifestyle	452	315	351	338	303
Lighting	3,168	3,531	3,604	3,682	4,133
Innovation, Group & Services	6	7	7		
Philips Group	3,996	4,216	4,218	4,328	4,857

In 2012, 80% of water was purchased and 20% was extracted from groundwater wells.

Waste

Total waste decreased 7% to 88 kilotonnes in 2012 from 94 kilotonnes in 2011. Lighting (74%) and Consumer Lifestyle (14%) account for 88% of our total waste. The reduction was due to the divestment of the Televsion activities and organizational changes in all sectors.

Total waste

in kilotonnes

	2008	2009	2010	2011	2012
Healthcare	8.2	8.2	11.2	9.3	10.4
Consumer Lifestyle	28.0	20.1	23.2	19.6	12.7
Lighting	77.3	69.3	70.1	65.1	64.5
Innovation, Group & Services	0.1	0.1	0.1		
Philips Group	113.6	97.7	104.6	94.0	87.6

Total waste consists of waste that is delivered for landfill, incineration or recycling. Materials delivered for recycling via an external contractor comprised 68 kilotonnes, which equated to 77% of total waste as improved recycling rates at our established sites were off-set by lower recycling rates at our new acquisitions. Of the remaining waste, 18% comprised non-hazardous waste and 5% hazardous waste.

Industrial waste delivered for recycling

in %

Emissions

Emissions of restricted substances totaled 55 kilos in 2012, a decrease of 50% compared to 2011, due to a 100% reduction in use of benzene because of the realized phase-out at Lighting. The level of emissions of hazardous substances increased by 7% from 65,477 to 70,093 kilos, mainly as a result of an increase in total Styrene emissions at Lighting, because of an acquired site that was reporting for the first time in 2012.

Restricted and hazardous substances

in kilos

	2008	2009	2010	2011	2012
Restricted substances	425	272	188	111	55
Hazardous substances	46,220	32,869	61,795	65,477	70,093

For more details on restricted and hazardous substances, please refer to section 14.3, Green Operations, of this report.

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5.4 Proposed distribution to shareholders

Pursuant to article 34 of the articles of association of Royal Philips Electronics, a dividend will first be declared on preference shares out of net income. The remainder of the net income, after reservations made with the approval of the Supervisory Board, shall be available for distribution to holders of common shares subject to shareholder approval after year-end. As of December 31, 2012, the issued share capital consists only of common shares; no preference shares have been issued. Article 33 of the articles of association of Royal Philips Electronics gives the Board of Management the power to determine what portion of the net income shall be retained by way of reserve, subject to the approval of the Supervisory Board.

A proposal will be submitted to the 2013 Annual General Meeting of Shareholders to declare a dividend of EUR 0.75 per common share (up to EUR 685 million), in cash or in shares at the option of the shareholder, against the net income for 2012 and the reserve retained earnings of the Company.

Shareholders will be given the opportunity to make their choice between cash and shares between May 10, 2013 and May 31, 2013. If no choice is made during this election period the dividend will be paid in shares. On May 31, 2013 after close of trading, the number of share dividend rights entitled to one new common share will be determined based on the volume weighted average price of all traded common shares Koninklijke Philips Electronics N.V. at Euronext Amsterdam on 29, 30 and 31 May 2013. The Company will calculate the number of share dividend rights entitled to one new common share, such that the gross dividend in shares will be approximately 1.5% higher than the gross dividend in cash. Payment of the dividend and delivery of new common shares, with settlement of fractions in cash, if required, will take place from June 5, 2013. The distribution of dividend in cash to holders of New York registry shares will be made in USD at the USD/EUR rate fixed by the European Central Bank on June 3, 2013.

Dividend in cash is in principle subject to 15% Dutch dividend withholding tax, which will be deducted from the dividend in cash paid to the shareholders. Dividend in shares paid out of earnings and retained earnings is subject to 15% dividend withholding tax, but only in respect of the par value of the shares (EUR 0.20 per share). This withholding tax in case of dividend in shares will be borne by Philips.

In 2012, a dividend of EUR 0.75 per common share was paid in cash or shares, at the option of the shareholder. Approximately 62.4% elected for a share dividend resulting in the issue of 30,522,107 new common shares, leading to a 3.4% percent dilution. EUR 255 million was paid in cash.

The balance sheet presented in this report, as part of the Company financial statements for the period ended December 31, 2012, is before appropriation of the result for the financial year 2012.

5.5 Outlook

By executing on our Accelerate! program, we will continue to relentlessly drive operational excellence and invest in innovation and sales development to deliver profitability and growth.

The challenging economic environment in 2012, notably in Europe and United States, has impacted our order book, and hence we expect our sales in 2013 to start slow and pick up in the second half of the year. We will continue to be prudent in our allocation of capital, and we will complete our share buy-back program in the course of 2013. We remain confident in our ability to further improve our operational and financial performance, enabling us to achieve our Accelerate! mid-term 2013 financial targets.

5.6 Critical accounting policies

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 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 make 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 more detailed description of Philips accounting policies appears in section 12.10, Significant accounting policies, of this report.

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. The accounting requires management to make assumptions regarding variables such as discount rate, rate of compensation increase, mortality rate, return on assets, and future healthcare costs. Pension assumptions are set centrally by management in consultation with its local, regional or country management and locally appointed actuaries at least once a year. For the Company s major plans, a full discount rate curve of high quality corporate bonds (Towers Watson RATE:Link) is used to determine the defined benefit obligation whereas for other plans a single point discount rate is used based on the plan s maturity. Plans in countries without a deep corporate bond market, use a discount rate based on the local sovereign curve and the plan s maturity. Relevant data regarding various local swap curves, sovereign bond curves and/or corporate AA bonds are set by local actuaries. Changes in the key assumptions can have a significant impact on the projected benefit obligations, funding requirements and periodic cost incurred.

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For a discussion of the current funded status, a sensitivity analysis with respect to pension plan assumptions, a summary of the changes in the accumulated postretirement benefit obligations and a reconciliation of the obligations to the amounts recognized in the consolidated balance sheet, please refer to note 29, Pensions and other postretirement benefits.

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 in which it conducts business. 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 regularly reviews the deferred tax assets for recoverability and will only recognize these if it is believed that sufficient future taxable profit is available, including income from forecasted operating earnings, the reversal of existing taxable temporary differences and established tax planning relating to the same taxation authority and the same taxable entity. For a discussion of the fiscal uncertainties, please refer to the information under the heading Tax risks in note 3, Income taxes.

Provisions and Contingent liabilities

The Company and certain of its group companies and former group companies are involved as a party in legal proceedings, including regulatory and other governmental proceedings, and discussions on potential remedial actions, relating to such matters as antitrust laws, competition issues, commercial transactions, product liabilities, participations and environmental pollution. Since the ultimate disposition of asserted claims and proceedings and investigations cannot be predicted with certainty, an adverse outcome could have a material adverse effect on the Company s Consolidated financial statements.

The Company recognizes a liability when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. If the likelihood of the outcome is less than probable and more than remote or a reliable estimate is not determinable, the matter is disclosed as a contingent liability if management concludes that it is material.

In determining the provision for losses associated with environmental remediation obligations, significant professional judgments are necessary. The Company utilizes experts in the estimation process. The Company accrues for losses associated with environmental obligations when such losses are probable and can be estimated reliably. The provisions are adjusted as new information becomes available and they are remeasured at the end of each period using the current discount rate.

Provisions on restructuring represents estimated costs of initiated reorganizations, the most significant of which have been approved by the Board of Management. A liability is recognized for those costs only when the Company has a detailed formal plan for the restructuring and has raised a valid expectation with those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Provisions on onerous contracts represent the lesser of the unavoidable costs of either fulfilling or exiting the related contract, and in which the costs to fulfill the contract exceed the benefits expected to be received under such contract. In determining the cost of fulfilling the contract, the payments due in the period in which the contract cannot be cancelled are considered, unless there is a lesser amount of penalty to exit the contract. Generally, unavoidable costs only include incremental costs related to the contract and exclude allocated or shared costs. Before a provision is established, the Company recognizes any impairment loss on the assets associated with that contract.

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. The provision is based on historical warranty data and a weighing of possible outcomes against their associated probabilities.

Provision for obsolete inventories

The Company records its inventories at cost and provides for the risk of obsolescence using the lower of cost and net realizable value principle. The expected future use of inventory is based on estimates about future demand and past experience with similar inventories and their usage.

Provision for bad debts

The risk of uncollectability 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 collectability risk, which is taken into account when assessing the risk of uncollectability. Should the outcome differ from the assumptions and estimates, revisions to the estimated valuation allowances would be required.

Impairment of non-financial assets

Goodwill is not amortized, but tested for impairment annually and whenever impairment indicators require so. The Company reviews non-financial assets, other than goodwill for impairment, when events or circumstances indicate that carrying amounts may not be recoverable.

In determining impairments of non-current assets like intangible assets, property, plant and equipment, investments in associates and goodwill, management must make significant judgments and estimates to determine whether the recoverable amount is lower than the carrying value. Changes in assumptions and estimates included within the impairment reviews and tests could result in significantly different results than those recorded in the consolidated financial statements.

The recoverable amount is the higher of the asset s value in use and its fair value less costs to sell, the determination of which involves significant judgment and estimates from management.

Goodwill is allocated to the cash generating units. The basis of the recoverable amount used in the annual impairment test (performed in Q2) and trigger-based impairment tests is generally the value in use. Key assumptions used in the impairment tests were sales growth rates, income from operations and the rates used for discounting the projected cash flows. These cash flow projections were determined using management s internal forecasts that cover an initial period from 2012 to 2016 that matches the period used for our strategic review. Projections were extrapolated with stable or declining growth rates for a period of five years, after which a terminal value was calculated. For terminal value calculation, growth rates were capped at a historical long term average growth rate.

The sales growth rates and margins used to estimate cash flows are based on past performance, external market growth assumptions and industry long-term growth averages. Income from operations in all units is expected to increase over the projection period as a result of volume growth and cost efficiencies. Please refer to note 9, Goodwill.

New Accounting Standards

For a description of the new pronouncements, please refer to the information under the heading IFRS accounting standard adopted as from 2013 and onwards in section 12.10, Significant accounting policies, of this report.

Off-balance sheet arrangements

Please refer to the information under the heading Guarantees in sub-section 5.1.23, Cash obligations, of this report and in note 25, Contingent liabilities.

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6 Sector performance

Group Innovation Group & Regional Overheads Pensions Global Service Units New Venture Integration Design

Our structure

Koninklijke Philips Electronics N.V. (the Company) is the parent company of the Philips Group (Philips or the Group). The Company is managed by the members of the Board of Management and Executive Committee under the supervision of the Supervisory Board. The Executive Committee operates under the chairmanship of the Chief Executive Officer and shares responsibility for the deployment of Philips strategy and policies, and the achievement of its objectives and results.

Philips activities in the field of health and well-being are organized on a sector basis, with each operating sector Healthcare, Consumer Lifestyle and Lighting being responsible for the management of its businesses worldwide.

The Innovation, Group & Services sector provides the operating sectors with support through shared service centers. Furthermore, country management organization supports the creation of value, connecting Philips with key stakeholders, especially our employees, customers, government and society. The sector also includes pensions.

Members of the Board of Management and certain key

officers together form the Executive Committee

Also included under Innovation, Group & Services are the activities through which Philips invests in projects that are currently not part of the operating sectors, but which could lead to additional organic growth or create value through future spin-offs.

At the end of 2012, Philips had 120 production sites in 29 countries, sales and service outlets in approximately 100 countries, and 118,087 employees.

Sales, IFO and Adjusted IFO 2012

in millions of euros unless otherwise stated

	sales	IFO	%	Adjusted IFO[1]	%
Healthcare	9,983	1,122	11.2	1,322	13.2
Consumer Lifestyle	5,953	593	10.0	663	11.1
Lighting	8,442	(6)	(0.1)	188	2.2
Innovation, Group & Services	410	(679)		(671)	
Philips Group	24,788	1,030	4.2	1,502	6.1

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

6.1 Healthcare

Health care systems throughout the world are rapidly changing to meet the needs of a changing society. Philips Healthcare is prepared to match the pace of change with innovative solutions that connect and empower patients and their caregivers in new and profound ways. Through the Accelerate! program, Philips Healthcare will speed up innovation, raise customer service and improve value creation. **Deborah DiSanzo**, CEO Philips Healthcare

The spiraling cost of managing health care for the world s aging population presents a major challenge to society.

The global demand for care delivery is increasing which in turn places a significant burden on under- resourced health care systems, governments and health care providers around the world.

We continued to implement Accelerate! across our global Healthcare business to provide the industry with the most innovative solutions to address these needs.

6.1.1 Health care landscape

In today s health care environment, there are two powerful dynamics at work, which together are challenging the status quo and driving the need for transformational change.

In developed markets, the increasing cost of treating our aging world population, combined with a rise in chronic disease and a shortage of qualified healthcare workers, presents a major challenge to the delivery of care. Concurrently, the continual need for broader access to care has reached critical levels in growth markets. At

Philips, we see the ability to provide connected solutions across the continuum of care as key to addressing these pressing issues. Technological advancements are changing and will continue to change how patient care is delivered from the hospital to the home and points in between for improved outcomes, better value and greater access to effective diagnosis and treatment.

The global economic slowdown and continuing crisis in the Euro zone had a negative impact on our European business in 2012, particularly in Southern Europe. This situation was balanced in part by continued growth in North America, Japan and in growth geographies.

6.1.2 Creating the future of health care

Our health care innovations and ongoing partnership with customers are helping us lay the groundwork for the transformational change of our global health care system.

We continue to introduce solutions and services that connect and empower patients, their providers and support network for the more efficient and productive delivery of care.

We are also developing new products in growth geographies to make state-of-the-art technology affordable and accessible to these markets while investing in creative solutions specifically designed to make quality care possible for the underserved.

6.1.3 About Philips Healthcare

As a global leader in health care, we are guided by the understanding that there is a patient at the center of everything we do. By pioneering new solutions that improve and expand care around the world, we are dedicated to creating the ideal experience for all patients, young and old.

We harness the power of clinical information by providing clinicians and health care providers with real-time information all in one place across modalities, time zones and technologies for more confident decision-making and efficient workflow.

We focus on delivering the most technologically advanced products and solutions, as we help clinicians diagnose, treat and manage many of today s most prevalent diseases.

We expand access to care by promoting the adoption of new mobile and remote technologies and developing new protocols that can lead to more efficient and productive health care systems.

These commitments are the driving force behind our research and investment in promising new approaches to radiology, cardiology, oncology, decision support, home health, respiratory and other critical areas.

Our Healthcare business is organized around four strategic business groups:

Imaging Systems: Integrated clinical solutions that include radiation oncology, clinical applications and platforms, and portfolio management; advanced diagnostic imaging, including computed tomography (CT), magnetic resonance imaging (MRI) and molecular imaging (MI); diagnostic X-ray, including digital X-ray and mammography; interventional X-ray, encompassing cardiology, radiology, surgery and other areas; and ultrasound, a modality with diverse customers and broad clinical presence.

Patient Care & Clinical Informatics: Enterprise patient monitoring solutions, from value solutions to sophisticated connected solutions, for real-time clinical information at the patient s bedside; cardiology informatics and enterprise imaging informatics, including picture archiving and communication systems and other clinical information systems; patient monitoring and clinical informatics; mother and child care, including products and solutions for pregnancy, labor and delivery, newborn and neonatal intensive care and the transition home; and therapeutic care, including cardiac resuscitation, emergency care solutions, therapeutic temperature management, anesthesia care, hospital respiratory systems and ventilation.

Home Healthcare Solutions: Sleep management, respiratory care and non-invasive ventilation; medical alert and medication dispensing services for independent living; and remote patient monitoring.

Customer Services: Equipment services and support, including service contracts, equipment maintenance, proactive monitoring and multi-vendor services; managed service programs, including equipment financing and asset management; and professional services, including consulting, site planning and project management, education, and design.

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Total sales by business 2012

as a %

Philips is one of the world s leading health care companies (based on sales) along with General Electric and Siemens. The United States, our largest market, represented 41% of our Healthcare business s global sales in 2012, followed by Japan, China and Germany. Growth geographies accounted for 24% of Healthcare sales. Philips Healthcare employs approximately 37,500 employees worldwide.

Sales at Healthcare are generally higher in the second half of the year largely due to the timing of new product availability and customer spending patterns.

Regulatory requirements

Philips Healthcare is subject to extensive regulation. We are committed to compliance with regulatory product approval and quality system requirements in every market we serve by addressing specific terms and conditions of local and national regulatory authorities, including the US FDA and comparable foreign agencies. Obtaining their approval is costly and time-consuming, but a prerequisite for market introduction.

With regard to sourcing, please refer to section 14.5, Supplier indicators, of this report.

6.1.4 Progress against targets

The Annual Report 2011 set out a number of key targets for Philips Healthcare in 2012 that are steps towards achieving our Accelerate! mid-term 2013 goals. Our progress is outlined below.

Implement Accelerate! transformation

The launch of Accelerating Healthcare in 2012 put us on a fast track to eliminate organizational complexity as a barrier to higher performance. We established Lean operating principles and enhanced the alignment of our product-creation and customer-facing teams to ensure speed of execution while maintaining quality.

This included designing for cost by leveraging value engineering.

We also continued to increase our presence and industrial footprint in growth geographies and to expand our value offering and locally relevant services.

Driving to co-leadership in Imaging Systems

Our Imaging 2.0 initiative continued to deliver share gains, as well as awards for quality, performance and reliability, with over 15 new products and features introduced in 2012. Our innovative integrated clinical solutions include elastography; iterative image reconstruction technique for virtually noise free image quality; cardiovascular x-ray system software that allows a significant reduction in X-ray dose while preserving image quality; a software application that converts analog MR images to digitized MR images; and a multi-vendor workstation that integrates image history across modality for easy collaboration among physicians.

We announced new strategic alliances in 2012, including a program with Elekta in Sweden to develop a potential breakthrough in cancer care. We also entered into an exclusive distribution agreement with Corindus Vascular Robotics in the US for one of their state-of-the-art robotic-assisted systems.

Achieving leadership with holistic innovation in Patient Care & Clinical Informatics

A number of important advancements in 2012 helped strengthen our leadership position in clinical decision support and address the specific needs of high-growth geographies, such as Brazil, China and India. These included FDA clearance for two groundbreaking clinical decision support applications for our patient monitors, and innovative solutions for interoperability, defibrillation, clinical informatics, anesthesia care and patient monitoring.

We also collaborated with customers on initiatives with far-reaching implications. With Maxima Medical Center in the Netherlands, we created a new concept in neonatal intensive care called the Woman-Mother-Child Center, where mothers and their newborn babies are kept together for fully integrated treatment and nursing care.

International expansion of the Home Healthcare Solutions business

Our Home Healthcare Solutions business grew at or above market rates in 2012, with strong growth in Japan, Western Europe and other geographies where home health care as part of chronic disease management is a fundamental component of the care continuum.

We also continued to lead the way in helping shape selected regional markets in the early stages of home health care development. In these markets, we focused on building awareness of chronic conditions and understanding the value of home health care while making investments in research and clinical education.

Invest for leadership in growth geographies

In 2012 we made a number of strategic investments in growth geographies. These included the opening of research and development centers and manufacturing facilities in China and India to drive local innovation. We also strengthened our presence in the Middle East with strategic alliances in Saudi Arabia and Abu Dhabi.

In addition, we extended our innovative telehealth solution to provide remote critical care in India, and continued to expand our solutions in imaging, patient monitoring and clinical informatics for price-sensitive markets, such as Brazil and China.

Executing operational excellence initiatives to increase margin and time-to-market

Under Accelerate! we made significant progress in the restructuring of our organization to innovate faster and more efficiently.

Deliver on EcoVision sustainability commitments

As part of our EcoDesign process, we consider all Green Focal Areas to help reduce total life cycle impact. In 2012 we introduced 16 Green Products to support energy efficiency, materials reduction and other sustainability goals.

6.1.5 2012 financial performance

Key data
in millions of euros unless otherwise stated

	2010	2011	2012
Sales	8,601	8,852	9,983
Sales growth			
% increase, nominal	10	3	13
% increase, comparable[1)]	4	5	6
Adjusted IFO[1)]	1,186	1,145	1,322
as a % of sales	13.8	12.9	13.2
IFO	922	93	1,122
as a % of sales	10.7	1.1	11.2
Net operating capital (NOC)[1)]	8,908	8,418	7,976
Cash flows before financing activities[1)]	1,141	773	1,394
Employees (FTEs)	36,253	37,955	37,460

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2012, sales amounted to EUR 9,983 million, 13% higher than in 2011 on a nominal basis, driven by higher sales in all businesses. Excluding a 7% favorable impact of currency effects, comparable sales were 6% higher. Solid mid-single-digit comparable sales growth was achieved by all businesses. Green Product sales amounted to EUR 3,610 million, a 36% year-on-year increase.

Geographically, comparable sales in mature geographies were higher than in 2011 in all businesses. The year-on-year sales increase was largely attributable to North America and other mature markets, as sales in Western Europe were in line with the prior year. In growth geographies, we achieved 20% growth, largely driven by strong, double-digit growth in China, Brazil, India and Russia.

Adjusted IFO increased from EUR 1,145 million, or 12.9% of sales, in 2011 to EUR 1,322 million, or 13.2% of sales, in 2012. Adjusted IFO improvements were realized at all businesses, largely as a result of higher sales and cost-saving programs. Restructuring and acquisition-related charges amounted to EUR 134 million, compared with EUR 20 million in 2011.

IFO amounted to EUR 1,122 million, or 11.2% of sales, and included EUR 200 million of charges related to amortization of intangible assets.

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Net operating capital in 2012 decreased by EUR 442 million to EUR 8 billion, mainly due to currency effects and an increase in provisions related to restructuring charges. All businesses showed improved efficiency in inventory usage year-over-year.

Cash flows before financing activities increased from an inflow of EUR 773 million in 2011 to an inflow of EUR 1,394 million in 2012, mainly attributable to higher earnings and lower working capital requirements.

Sales per geographic cluster

in millions of euros

Sales and net operating capital

in billions of euros

IFO and Adjusted IFO[1)]

in millions of euros

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

2011 financial performance

In 2011, sales amounted to EUR 8,852 million, 3% higher than in 2010 on a nominal basis, driven by higher sales in all businesses. Excluding a 2% unfavorable impact of currency effects, comparable sales were 5% higher. Mid-single-digit comparable sales growth was achieved by all businesses. Green Product sales amounted to EUR 2,663 million, a 25% year-on-year increase.

Geographically, comparable sales in mature geographies were higher than in 2010 in all businesses except Imaging Systems. The year-on-year sales increase was largely attributable to North America, tempered by lower sales in Western Europe. In growth geographies, we achieved 15% growth, largely driven by strong, double-digit growth in China, India and Russia.

Adjusted IFO decreased from EUR 1,186 million, or 13.8% of sales, in 2010 to EUR 1,145 million, or 12.9% of sales, in 2011. Adjusted IFO improvements were realized at Patient Care & Clinical Informatics, Home Healthcare Solutions and Customer Services, largely as a result of higher sales and cost-saving programs. However, this was more than offset by lower Adjusted IFO at Imaging Systems, due to higher selling expenses and investments in R&D. Restructuring and acquisition-related charges amounted to EUR 20 million, compared with EUR 77 million in 2010.

IFO amounted to EUR 93 million, or 1.1% of sales, and included EUR 229 million of charges related to amortization of intangible fixed assets and EUR 824 million of goodwill impairment losses.

Net operating capital in 2011 decreased by EUR 490 million to EUR 8.4 billion, mainly attributable to lower intangible assets due to goodwill impairment and partially offset by higher inventories, primarily at Imaging Systems.

Cash flows before financing activities decreased from an inflow of EUR 1,141 million in 2010 to an inflow of EUR 773 million in 2011, mainly attributable to lower cash earnings.

6.1.6 2013 priorities

In 2013 Philips Healthcare will continue to progress on the following imperatives designed to accelerate performance and achieve our goals:

- Complete our Accelerating Healthcare transformation
- Invest in our growth initiatives to deliver differentiated offerings from the hospital to the home
- Create momentum behind Customer Services

Implement our end-to-end customer relationship management solution across the global Philips Healthcare organization

Create a high-performance organization as measured by ongoing employee surveys and business results

Institutionalize our end-to-end operating framework to optimize financial returns on our portfolio and improve the customer experience
In addition to these priorities, Philips Healthcare will continue to deliver on EcoVision sustainability commitments.

6.2 Consumer Lifestyle

At Consumer Lifestyle we re making the world healthier and more sustainable through meaningful innovation. The Accelerate! transformation program is now showing solid results in our sector. By planning, resourcing and managing performance by Business Market Combination (BMC), we are driving greater consumer intimacy, enabling us to launch more locally relevant products. We continue to transform Consumer Lifestyle for profitable growth, reshaping our portfolio towards health and well-being. **Pieter Nota,** CEO Philips Consumer Lifestyle

New operating model fully in place, moving decisions closer to markets and stimulating entrepreneurship and speed.

Granular approach to growth is showing solid results, addressing local consumer needs and leveraging our position in attractive growth geographies.

Announced start of Television joint venture named TP Vision, ensuring the future of the Philips brand in Television.

January 2013 announcement of agreement to transfer Audio, Video, Multimedia and Accessories businesses to Funai.

6.2.1 Lifestyle retail landscape

Across the world, consumers want to maintain and improve their health and well-being. To achieve this, they seek propositions that help them to look and feel their best and to care for their family and friends: propositions that help them to live well. This is as true of consumers in growth geographies such as China as it is in developed markets such as Western Europe.

In 2012 economic headwinds increased, resulting in pressure on consumer spending in some markets. However, we believe consumers will continue to demand products that enhance their health and well-being, creating resilience in our product categories.

Underlying trends continue to drive growth in our key categories:

- Consumers have a growing interest in personal health
- Consumers are increasingly appearance-conscious
- Consumers want healthy food that is also easy to prepare
- In a complex market environment, consumers look for responsible brands they can trust

6.2.2 Helping people achieve a healthier and better life

Consumer Lifestyle makes a difference to people s lives by making it easier for them to achieve a healthier and better lifestyle.

Consumer Lifestyle empowers its business and market organizations to work together in order to address the different and changing needs of consumers and customers across the world.

We are increasing the speed, quality and local relevance of product innovation and expanding our distribution, thereby capturing the increasing spending power of growth geographies.

6.2.3 About Consumer Lifestyle

At Consumer Lifestyle we are delivering on Philips vision to make the world healthier and more sustainable through innovation. We have a global footprint, with an established presence in both mature and growth geographies. Our investment in innovation and local business creation enables us to deliver a stream of locally relevant, meaningful innovations. We have a leading global brand, which is highly trusted across the world.

The Philips Consumer Lifestyle sector is organized around its businesses and markets, and is focused on value creation through category development and delivery through operational excellence.

We plan, resource and manage performance by Business Market Combination (BMC). Our operating model stimulates entrepreneurship and speed by ensuring clear accountability and by moving decisions closer to our customers and markets.

In 2012 the sector consisted of the following areas of business:

Health & Wellness: mother and childcare, oral healthcare

Personal Care: male grooming, skincare, beauty

Domestic Appliances: coffee, floor care, garment care, kitchen appliances, water & air, beverage appliances

Lifestyle Entertainment: audio and video entertainment; communications, headphones and accessories

Total sales by business 2012

as a %

We offer a broad range of products from high to low price/value quartiles, necessitating a diverse distribution model. We continue to expand our portfolio to increase its accessibility, particularly for lower-tier cities in growth geographies. We have implemented innovative approaches in online and social media to build our brand and drive sales.

Under normal economic conditions, the Consumer Lifestyle sector experiences seasonality, with higher sales in the fourth quarter resulting from the holiday sales.

Consumer Lifestyle employs approximately 18,900 people worldwide. Our global sales and service organization covers more than 50 developed and growth geographies. In addition, we operate manufacturing and business creation organizations in Austria, Brazil, China, India, Indonesia, Italy, Netherlands, Romania, the UK and the US.

Regulatory requirements

Consumer Lifestyle is subject to significant regulatory requirements in the markets where it operates. This includes the European Union s Waste from Electrical and Electronic Equipment (WEEE), Restriction of Hazardous Substances (RoHS) and Energy-use of Products (EuP) requirements. Consumer Lifestyle has a growing portfolio of medically regulated products in its Health & Wellness and Personal Care businesses. For these products we strive to meet the requirements of the US FDA, the European Medical Device Directive, the SFDA in China and the regulations stipulated by Health Authorities in India. Through our growing skincare product portfolio the range of applicable regulations has been extended to include requirements relating to cosmetics and, on a very small scale, pharmaceuticals.

With regard to sourcing, please refer to section 14.5, Supplier indicators, of this report.

6.2.4 Progress against targets

The Annual Report 2011 set out a number of key targets for Philips Consumer Lifestyle in 2012 that are steps towards achieving our Accelerate! mid-term 2013 goals. Our progress is outlined below.

Implement Accelerate! transformation

In Consumer Lifestyle, Accelerate! is showing solid results. Taking a granular approach to growth, we now have 150 BMC plans in place. We have moved from a functional, centrally-led organization to an organization built around businesses and markets. We have clear accountability in our operating model, for both businesses and markets. We have seven end-to-end transformation pilots in place with clear deliverables: reduced time-to-market, reduced inventories and better gross margin management.

Right-size the organization post TV joint venture establishment

We have significantly reduced overhead costs and stranded costs related to the establishment of the TV joint venture with TPV, TP Vision, which was established on April 1, 2012. Key actions taken include streamlining the headcount in the Supply Chain Management, Manufacturing and Support functions, realigning International Key Account Management, rationalizing the central Marketing set-up, reducing logistics and warehousing costs through structural improvements, and reducing the real estate footprint.

Address Lifestyle Entertainment portfolio and execute turn-around plan

We continued to transition the portfolio towards growing categories like docking and connected entertainment, away from rapidly declining categories like MP3, MP4 and DVD players. We reduced the business s cost base to reflect the lower revenue base. In North America we entered into a distribution agreement with Funai, a longstanding Philips business partner, in 2012. We also divested the Speech Processing business in Lifestyle Entertainment, selling it to Invest AG. In January 2013 we announced an agreement to transfer our Audio, Video, Multimedia and Accessories businesses to Funai.

Continued growth investment in core businesses towards global category leadership

In our key growth businesses of Male Grooming, Oral Healthcare, Kitchen Appliances and Coffee (which includes our Espresso and Beverage Appliance categories), we made significant progress in 2012. In Male Grooming, we have increased our share of the total market (including blade shaving), strengthening our leading position. In Oral Healthcare, we are entering new channels, including pharmacies, with the launch of the Sonicare PowerUp power toothbrush.

In Kitchen Appliances, acquisitions and local product creation have driven a strong increase in new product offerings, with leadership in key markets strengthened through local relevance. In Coffee, a new, long-term agreement with DE Master Blenders has further strengthened the Senseo business.

Regional business creation; leverage fill-in acquisitions in China and India

Leading kitchen appliances companies Preethi and Povos, acquired in 2011 in India and China respectively, continued to show strength. Povos contributed to an incremental 30% growth in China by strengthening our Chinese product offering. Preethi s leadership in the south of India complements our position across India, where we have over 30% market share in mixer grinders, the largest category. We are also leveraging the Preethi brand to build a portfolio beyond kitchen appliances.

Deliver on EcoVision sustainability commitments

Sustainability continues to play an important role in the product development process at Consumer Lifestyle. In 2012 we made progress in implementing our voluntary commitment to phase out polyvinyl chloride (PVC) and brominated flame retardants (BFR) from our products, and for the first time all of our espresso coffee machines launched during the year are free of these substances.

We increased the use of recycled materials in our products. For example, the housing base of the Performer range of vacuum cleaners is now made from recycled plastics, resulting in the use of approximately 300 tonnes of recycled plastic by 2013.

6.2.5 2012 financial performance

Key data

in millions of euros unless otherwise stated

	2010	2011	2012
Sales	5,504	5,615	5,953
Sales growth			
% increase (decrease), nominal	7	2	6
% increase (decrease), comparable[1)]		1	2
Adjusted IFO[1)]	487	297	663
as a % of sales	8.8	5.3	11.1
IFO	449	217	593
as a % of sales	8.2	3.9	10.0
Net operating capital (NOC)[1)]	882	884	1,217
Cash flows before financing activities[1)]	288	(257)	597
Employees (FTEs)	14,095	18,291	18,911

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

Sales amounted to EUR 5,953 million, a nominal increase of 6% compared to 2011, mainly driven by double-digit growth in our Health & Wellness and Domestic Appliances businesses. This was partly offset by a double-digit decline in Lifestyle Entertainment, where growth was adversely affected by a slowdown in consumer spending, particularly in mature geographies. Excluding a 3% favorable currency impact and a 1% impact from portfolio changes, comparable sales were 2% higher than the previous year.

From a geographical perspective, we recorded 7% comparable sales growth in growth geographies, which was partly offset by a 2% decline in mature geographies, mainly in Western Europe. In growth geographies, the year-on-year sales increase was driven by Russia and China, primarily in our Domestic Appliances and Personal Care businesses. Growth geographies share of sector sales increased from 42% in 2011 to 46% in 2012.

Adjusted IFO increased from EUR 297 million, or 5.3% of sales, in 2011 to EUR 663 million, or 11.1% of sales, in 2012. Restructuring and acquisition-related charges amounted to EUR 75 million in 2012, compared to EUR 54 million in 2011. 2012 results included a EUR 160 million one-time gain from the extension of our partnership with Sara Lee, including the transfer of our 50% ownership right to the Senseo trademark. Excluding this one-time gain, the year-on-year Adjusted IFO increase was driven by higher sales across all growth businesses as well as lower net costs formerly reported as part of the Television business. Compared to 2011, Adjusted IFO improvements were seen in all businesses.

IFO amounted to EUR 593 million, or 10.0% of sales, which included EUR 70 million of amortization charges, mainly related to intangible assets in Health & Wellness and Domestic Appliances.

Net operating capital increased from EUR 884 million in 2011 to EUR 1,217 million in 2012, primarily due to a reduction in the accounts payable balance related to the former Television business in Consumer Lifestyle.

Cash flows before financing activities increased from a cash outflow of EUR 257 million in 2011 to a cash inflow of EUR 597 million. The increase was attributable to higher cash earnings, lower cash outflows for acquisitions as well as the transfer of our 50% ownership right to the Senseo trademark to Sara Lee for cash proceeds EUR 170 million.

Sales per geographic cluster

in millions of euros

Sales and net operating capital

in billions of euros

IFO and Adjusted IFO[1)]

in millions of euros

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

2011 financial performance

2011 proved to be a challenging year for driving sales growth in Consumer Lifestyle. We began the year with sales declines in the first two quarters, though we finished the year with two quarters of positive growth and improved stock levels. For the year, sales increased by EUR 111 million, or 2% nominal growth. Excluding the effect of unfavorable currency and favorable portfolio changes, comparable sales were 1% higher from the previous year.

We achieved double-digit growth at Health & Wellness and high single-digit growth at Personal Care, driven by increased investment in advertising and promotion. Sales at Domestic Appliances showed high single-digit growth, led by strong growth in growth geographies, notably China. Sales declined at Lifestyle Entertainment, where growth was tempered by slow consumer spending in mature geographies.

From a geographical perspective, we recorded 10% comparable sales growth in growth geographies, which was partly offset by a 4% decline in mature geographies, mainly in Western Europe. Sales growth in growth geographies was driven by solid growth in Latin America and China, primarily in our Personal Care business. Growth geographies share of sector sales increased from 39% in 2010 to 42% in 2011.

Adjusted IFO decreased from EUR 487 million, or 8.8% of sales, in 2010 to EUR 297 million, or 5.3% of sales, in 2011. Restructuring and acquisition-related charges amounted to EUR 54 million in 2011, compared to EUR 31 million in 2010. The year-on-year Adjusted IFO decrease was largely attributable to lower gross margin and higher selling expenses, particularly from increased investment in advertising and promotion. Adjusted IFO was higher than in 2010 at Health & Wellness, but this was more than offset by lower earnings at Lifestyle Entertainment and Licenses.

IFO amounted to EUR 217 million, or 3.9% of sales, which included EUR 80 million of amortization charges, mainly related to intangible fixed assets at Lifestyle Entertainment and Health & Wellness.

Net operating capital increased slightly from EUR 882 million in 2010 to EUR 884 million in 2011, primarily due to higher intangible fixed assets from acquisitions of Povos and Preethi, partially offset by higher provisions for the announced divestment of the discontinued Television business.

Cash flows before financing activities declined from an inflow of EUR 288 million in 2010 to an outflow of EUR 257 million in 2011. The decline was attributable to lower cash earnings and higher cash outflows for acquisitions.

6.2.6 2013 priorities

In 2013 Philips Consumer Lifestyle will continue to progress on the following imperatives designed to accelerate performance and achieve our goals:

Drive global scale and category leadership in health and well-being categories with attractive profit pools

Further reduce our cost base

Improve return on investment in marketing

Roll out end-to-end programs that will drive reduced time-to-market, reduced inventories and improved gross margins

In addition to these priorities, Philips Consumer Lifestyle will continue to deliver on EcoVision sustainability commitments.

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6.3 Lighting

The market for lighting is sizeable, attractive and growing. In the transition towards energy-efficient and LED-based lighting solutions, we are accelerating our Accelerate! program to excel in customer satisfaction, time-to-market, and end-to-end processes. In 2012 we made a significant step forward on our path to value. Our Accelerate! transformation and the turnaround of two of our business groups helped drive improved profitability. Going forward, Philips Lighting will continue to strengthen its global leadership position through meaningful innovations that enhance people s lives. **Eric Rondolat,** CEO Philips Lighting

The lighting industry is undergoing a radical transformation.

The lighting market is large and attractive, driven by major trends.

Strategy based on four priorities to maximize growth, improve performance and expand leadership.

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6.3.1 Lighting business landscape

We are witnessing a number of trends and transitions that will affect the lighting industry in the years to come and change the way people use and experience light.

We serve a large and attractive market that is driven by the need for more light, energy-efficient lighting, and digital lighting. Over half the world s population currently lives in urban areas: a figure that is expected to rise to over 70% by 2050. That means 3 billion extra city dwellers. These people will all need light. In addition, the world needs more energy-efficient light in the face of rising energy prices and climate change. At the same time, the lighting industry is moving from traditional to digital lighting lighting solutions enabled by the integration of LED technology, luminaires, lighting controls and software.

Between now and 2015 we expect the value of the global lighting market to grow by 5-7% on a compound annual basis. The majority of the growth will come from LED-based solutions and applications heading towards a 45% share by 2015 and from growth geographies.

In 2011 the lighting industry as a whole was recovering from the global economic developments in 2010. In 2012, however, this recovery slowed due to widespread downward pressure on GDP, weaker consumer markets in mature geographies, and continued weakness in the construction market. Growth geographies continue to show healthy growth, albeit somewhat at a slower pace.

6.3.2 Enhancing life with light

We believe that by focusing on what people really need and leveraging our expertise with a broad range of leading partners, we can create and deliver the most innovative and meaningful solutions on the market.

Our lighting solutions are transforming urban environments, helping to create livable cities by enhancing safety, municipal identity and residential well-being. Building owners and retailers are recognizing the benefits of energy-efficient lighting in reducing their operational costs. And schools are learning how lighting can improve education and well-being. At the same time, consumers are increasingly using lighting to create their own ambience at home as an expression of their lifestyle.

We believe that the rise of LED, coupled with our global market leadership, positions us well to continue to deliver on our mission to enhance life with light.

6.3.3 About Philips Lighting

Philips Lighting is a global market leader with recognized expertise in the development, manufacturing and application of innovative lighting solutions. We have pioneered many of the key breakthroughs in lighting over the past 121 years, laying the basis for our current strength and ensuring we are well-placed to be a leader in the digital transformation. We aim to further strengthen our position in the digital market through added investment in LED leadership while at the same time capitalizing on our broad portfolio, distribution and brand in conventional lighting (managing the golden tail there is a significant opportunity to grow market share and optimize profits in conventional lamps and drivers by flexibly anticipating the slower or faster phase-out of conventional products).

We address people s lighting needs across a full range of market segments. Indoors, we offer lighting solutions for homes, shops, offices, schools, hotels, factories and hospitals. Outdoors, we offer solutions for roads (street lighting and car lights) and for public spaces, residential areas and sports arenas. In addition, we address the desire for light-inspired experiences through architectural projects. Finally, we offer specific applications of lighting in specialized areas, such as horticulture and water purification.

Philips Lighting spans the entire lighting value chain from light sources, luminaires, electronics and controls to full applications and solutions through the following businesses:

Light Sources & Electronics: LED, eco-halogen, (compact) fluorescent, high-intensity discharge and incandescent light sources, plus electronic and electromagnetic gear, modules and drivers

Consumer Luminaires: functional, decorative, lifestyle, scene-setting luminaires

Professional Lighting Solutions: controls and luminaires for city beautification, road lighting, sports lighting, office lighting, shop/hospitality lighting, industry lighting

Automotive Lighting: car headlights, car signaling, interior

Lumileds: packaged LEDs.

The Light Sources & Electronics business conducts its sales and marketing activities through the professional, OEM and consumer channels, the latter also being used by our Consumer Luminaires business. Professional Lighting Solutions is organized in a trade business (commodity products) and a project solutions business (project luminaires, systems and services). Automotive Lighting is organized in two businesses: OEM and After-market.

The conventional lamps industry is highly consolidated, with GE and Siemens/Osram as key competitors. The LED lighting market, on the other hand, features a wide variety of competitors, ranging from start-ups to multinationals. The luminaires industry is fragmented, with our competition varying per region and per market segment.

Under normal economic conditions, Lighting s sales are generally not materially affected by seasonality.

Philips Lighting has manufacturing facilities in some 25 countries in all regions of the world, and sales organizations in more than 60 countries. Commercial activities in other countries are handled via distributors working with our International Sales organization. Lighting has 50,200 employees worldwide.

Regulatory requirements

Lighting is subject to significant regulatory requirements in the markets where it operates. These include the European Union s Waste from Electrical and Electronic Equipment (WEEE), Restriction of Hazardous Substances (RoHS), Energy-using Products (EuP) and Energy Performance of Buildings (EPBD) directives.

With regard to sourcing, please refer to section 14.5, Supplier indicators, of this report.

Total sales by business 2012

as a %

6.3.4 Progress against targets

The Annual Report 2011 set out a number of key targets for Philips Lighting in 2012 that are steps towards achieving our Accelerate! mid-term 2013 goals. Our progress is outlined below.

Implement Accelerate! transformation

We are speeding up implementation of the Accelerate! program. We have adapted our processes to improve deliveries in all our geographies. We are taking a granular approach to investment choices through our Business Market Combination (BMC) plans, which are based on local customer insights. We have projects running to increase revenue, expand margins and reduce time-to-market and inventories, and we are aligning our processes in order to better serve our customers. In addition, we are strengthening accountability and simplifying our way of working, leading to cost savings. Driving the whole transformation is the deployment of culture transformation programs across all levels of the organization.

Accelerate transformation to LED, applications and solutions

In 2012 we further strengthened our expertise in LED development and application. Our LED-based sales grew by 41% compared to 2011, representing some 22% of total Lighting sales. Sales growth of LED-based applications was approximately 58%. To strengthen our leadership position, we established a cost-reduction program for LED lamps and expanded our portfolio of LED solutions in professional, automotive and home segments.

We continued to invest in growing our solutions (luminaires, controls, software and services) business, and sales increased by 31% in 2012. We are creating value through seamless integration of controls and management software in our LED-based solutions.

With the journey from initial idea to marketable product taking only nine months, the development of our hue connected lighting system illustrates how our organization has embraced the journey to accelerate. Effective and efficient collaboration across multiple disciplines significantly shortened time-to-market for this ground-breaking solution.

Strengthen performance management and execution

We are stepping up the pace of Accelerate! to prepare our organization to take full advantage of LED-driven future opportunities. We have now connected our business and market teams through our BMC approach to win customers in key markets. Projects are reducing complexity, improving execution along our end-to-end customer value chain, and increasing speed to market all with the aim of driving market leadership, accelerating growth and boosting profitability.

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6 Sector performance 6.3.4 - 6.3.5

Address cost base, margin management and working capital

In 2012, as part of our organizational redesign and cost program, we took a fundamental approach to increase the speed and efficiency of our organization. We reduced the number of Business Groups from six to five. Regional layers have been simplified and regional teams no longer sit between markets and businesses. Significant reductions in overhead functions like IT, Human Resource Management and Finance & Accounting have been implemented. Furthermore, we have endeavored to optimize our industrial asset base for maximum efficiency and lowest cost. We have reduced our industrial footprint by 40% compared to 2008, with four sites closed and four divested in 2012.

To protect our margins, we further improved our product mix and implemented selective price increases, mainly in our conventional lamps and luminaires businesses, and also managed cost aggressively. While we continue to invest in innovation and our go-to market capabilities, we will continue to focus on overhead cost reductions and accelerate the rationalization of our industrial footprint.

Our focus on working capital management is clearly paying off. Tight management of the value and quality of inventory led to a year-on-year improvement of 1.9% of sales.

Deliver on turnaround of Lumileds and Consumer Luminaires

Good progress has been made towards turning around our Lumileds and Consumer Luminaires businesses. Both managed to achieve a return to profitability excluding restructuring and acquisition-related charges in Q4 2012. At Lumileds, actions have been taken to improve manufacturing yields and innovation effectiveness. Also, the go-to-market and distribution structure has been expanded and strengthened, resulting in incremental top-line growth. At Consumer Luminaires, successful actions have been taken to improve customer intimacy and our go-to-market strategy. In addition, actions have been taken to improve productivity and to improve the end-to-end supply chain costs. In China and India in particular, we have experienced strong growth with continued expansion of branded Philips Lighting stores and shop-in-shops.

Deliver on EcoVision sustainability commitments

In 2012, Philips Lighting invested EUR 325 million in Green Innovation, compared to EUR 291 million in 2011. Major investments have been made in energy-saving technologies such as OLED and lighting controls and in the reduction of regulated substances in our product portfolio.The energy efficiency of our total product portfolio improved from 36 to 38 lm/W, mainly because of the shift to LED lighting. Within the Green Operations 2015 program, we are on track to meet our commitments to reduce Lighting s environmental footprint. By using renewable energy and implementing energy-saving programs in our major operational sites, we have already reduced our carbon footprint by 23%. Currently 78% of our total waste is re-used as a result of recycling.

6.3.5 2012 financial performance

Key data
in millions of euros unless otherwise stated

	2010	2011	2012
Sales	7,552	7,638	8,442
Sales growth			
% increase, nominal	15	1	11
% increase, comparable[1)]	9	6	4
Adjusted IFO[1)]	863	445	188
as a % of sales	11.4	5.8	2.2
IFO	689	(362)	(6)
as a % of sales	9.1	(4.7)	(0.1)
Net operating capital (NOC)[1)]	5,506	4,965	4,635
Cash flows before financing activities[1)]	590	254	339
Employees (FTEs)	53,888	53,168	50,224

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

Sales amounted to EUR 8,442 million, a nominal increase of 11% compared to 2011, mainly driven by growth at Light Sources & Electronics and Professional Lighting Solutions, but tempered by a sales decline at Lumileds. Excluding a 5% favorable currency impact and a 2% impact from portfolio changes, comparable sales increased by 4%.

The year-on-year sales increase was substantially driven by growth geographies, which grew 7% on a comparable basis. As a proportion of total sales, sales in growth geographies increased slightly to 41% of total Lighting sales, driven by double-digit growth in China and India, compared to 40% in 2011. In mature geographies, sales growth was limited to low single-digits due to lower demand in North America and Western Europe, particularly for Professional Lighting Solutions and Consumer Luminaires.

Sales of LED-based products grew to over 22% of total sales, up from 16% in 2011, driven by Light Sources & Electronics and Professional Lighting Solutions. Sales of energy-efficient Green Products exceeded EUR 5,752 million, or 68% of sector sales.

Adjusted IFO amounted to EUR 188 million, or 2.2% of sales, compared to EUR 445 million, or 5.8% of sales, in 2011. Restructuring and acquisition-related charges amounted to EUR 315 million in 2012, compared to EUR 66 million in 2011. The decrease in Adjusted IFO was mainly attributable to higher restructuring and acquisition-related charges, as well as losses on the sale of industrial assets amounting to EUR 81 million, partly offset by higher sales.

IFO amounted to a loss of EUR 6 million, or negative 0.1% of sales, which included EUR 194 million of amortization charges, mainly related to intangible assets at Professional Lighting Solutions.

Net operating capital decreased by EUR 330 million to EUR 4.6 billion, primarily due to an increase in provisions related to restructuring, lower inventories and currency effects, partly offset by the consolidation of Indal.

Cash flows before financing activities increased from EUR 254 million in 2011 to EUR 339 million, mainly attributable to lower working capital outflows, partly offset by higher outflows for acquisitions.

Sales per geographic cluster

in millions of euros

Sales and net operating capital

in billions of euros

IFO and Adjusted IFO[1)]

in millions of euros

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

2011 financial performance

Sales amounted to EUR 7,638 million, a nominal increase of 1% compared to 2010, mainly driven by growth in our Professional Lighting Solutions business, Light Sources & Electronics, as well as ongoing growth of our Fluorescent and LED lamps, but tempered by declining sales at Lumileds and Consumer Luminaires. Excluding a 2% unfavorable currency impact and a 3% unfavorable consolidation effect, comparable sales increased by 6%.

The year-on-year sales increase was substantially driven by growth geographies, which grew over 10% on a comparable basis. Sales in growth geographies increased to over 40% of total Lighting sales, driven by China and India, compared to 38% in 2010. In mature geographies, sales growth was limited to low single digits due to lower demand in North America and Western Europe, particularly for Lumileds and Consumer Luminaires.

Our Light Sources & Electronics business grew strongly compared to 2010, buoyed by demand for high-end lamps in retail and growth geographies. Ongoing softness in the residential construction markets particularly in mature geographies meant that sales in our Consumer

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Luminaires business slightly declined compared to 2010. Sales of LED-based products grew to over 16% of total sales, up from 13% in 2010, driven by Light Sources & Electronics and Professional Lighting Solutions. Sales of energy-efficient Green Products exceeded EUR 4,571 million, or 60% of sector sales.

Adjusted IFO amounted to EUR 445 million, or 5.8% of sales, compared to EUR 863 million, or 11.4% of sales, in 2010 . Restructuring and acquisition-related charges amounted to EUR 66 million in 2011, compared to EUR 97 million in 2010. The Adjusted IFO decrease of EUR 418 million was mainly attributable to lower gross margin, due to raw material increases and higher investments in selling as well as research and development to drive growth.

IFO amounted to a loss of EUR 362 million, or 4.7% of sales, which included EUR 128 million related to the impairment of customer relationships and brand names resulting from the turnaround plan within Consumer Luminaires, and EUR 531 million of goodwill impairment losses related to revised growth and profitability expectations for our Luminaires businesses, which were taken in the second quarter of 2011.

Net operating capital declined by EUR 541 million to EUR 5.0 billion, due to decreases in intangible fixed assets from goodwill and other amortization, partially offset by currency translation.

Cash flows before financing activities declined from EUR 590 million in 2010 to EUR 254 million, reflecting lower cash earnings and additional growth-focused investments in capital expenditures.

Under normal economic conditions, the Lighting business sales are generally not materially affected by seasonality.

6.3.6 2013 priorities

In 2013 Philips Lighting will continue to progress on the following imperatives designed to accelerate performance and achieve our goals:

- Lead the technological revolution in Lighting, be the thought-leader in LED, and win the golden tail in conventional lighting
- Win in the professional market, developing and growing profitable solutions and services
- Win in consumer markets and develop new ways to go to market
- Use Accelerate! as our transformation and performance improvement platform throughout the whole organization

In addition to these priorities, Philips Lighting will continue to deliver on EcoVision sustainability commitments.

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6.4 Innovation, Group & Services

Innovation is absolutely core to what Philips is, and the way it ensures competitive edge and long-term value creation. We re all about creating value through innovation more quickly, and making sure we earn that return on investment. In 2012 we continued optimizing our innovation portfolio and improved execution. At the same time, we are placing increasing emphasis on initiatives designed to leverage our intellectual property leadership. **Jim Andrew,** Chief Innovation & Strategy Officer

Introduction

Innovation, Group & Services comprises the activities of the Group headquarters, including Philips global management and sustainability programs, country and regional management costs, and costs of pension and other postretirement benefit plans, as well as Group Innovation and New Venture Integration. Additionally, the global shared business services for purchasing, finance, human resources, IT, real estate and supply are reported in this sector.

Innovation, Group & Services plays an important role in the Accelerate! program, notably by helping to improve the end-to-end value chain. The end-to-end approach consists of three core processes: Idea to Market, Market to Order, and Order to Cash. Innovation, Group & Services supports Idea to Market in five focal areas: Speeding up time to market, Portfolio optimization, Driving breakthrough innovation, Improving innovation competences, and Restoring the image of Philips as an

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innovation leader. Based on deeper customer insights, enhanced capability and competency building, we are driving value more effectively.

6.4.1 Philips Group Innovation

Philips Group Innovation (PGI) feeds the innovation pipeline, enabling its business partners the three Philips operating sectors to create new business options through new technologies, venturing and intellectual property development, to improve time-to-market efficiency, and to increase innovation effectiveness via focused research and development activities. In addition, PGI opens up new value spaces beyond current sector scope or focus (Emerging Business Areas, EBAs), manages the EBA-related R&D portfolio, and creates synergy for cross-sector initiatives.

PGI encompasses Philips Research, Philips Intellectual Property & Standards (IP&S), Philips Innovation Services, the Philips Innovation Campus, Philips Design as well as Emerging Business Areas. In total, PGI employs some 4,800 professionals around the globe.

PGI actively participates in Open Innovation through relationships with academic and industrial partners, as well as via European and regional projects, in order to improve innovation efficiency and share the related financial exposure. The High Tech Campus in Eindhoven (Netherlands), the Philips Innovation Campus in Bangalore (India), and Research Shanghai (China), are prime examples of environments enabling Open Innovation. In this way, we also seek to ensure proximity of innovation activities to growth geographies.

Philips Research

Philips Research is the main partner of Philips operating sectors for technology-enabled innovation. It creates new technologies and the related intellectual property (IP), which enables Philips to grow in businesses and markets. Together with the sectors, Philips Research also co-creates innovations and game-changers to strengthen the core businesses as well as to open up new business in adjacencies beyond the core. Research s innovation pipeline is aligned with our vision and strategy and inspired by major societal challenges as well as unmet customer needs.

One such challenge is the huge increase in the number of patients living with cancer. In the Netherlands, Philips Research and University Medical Center Utrecht have started a pilot clinical study to evaluate a new personalized treatment for breast cancer based on a technology called MR-guided High Intensity Focused Ultrasound (MR-HIFU). MR-HIFU has emerged as a technology with the potential to non-invasively destroy tumors by heating them up while they are still inside the body. Magnetic Resonance (MR) imaging provides real-time imaging of soft tissue structures so that the HIFU beam can be accurately focused onto the tumor.

Building on its expertise in LED lighting applications, Philips Research has been testing and validating new LED-based retail lighting concepts, designed to enhance the product appearance of fashion merchandise in shops, at multiple customer locations.

On January 1, 2012, the front-end innovation competencies of Lighting and the Healthcare R&D lab in Paris were integrated into Philips Research, thereby strengthening cooperation in the early stages of the innovation chain.

Philips Intellectual Property & Standards

Philips IP&S proactively pursues the creation of new intellectual property in close co-operation with Philips operating sectors and Philips Group Innovation. IP&S is a leading industrial IP organization providing world-class IP solutions to Philips businesses to support their growth, competitiveness and profitability. Philips IP portfolio currently consists of around 59,000 patent rights, 35,000 trademarks, 81,000 design rights and 4,200 domain name registrations. Philips filed approximately 1,500 patents in 2012, with a strong focus on the growth areas in health and well-being. IP&S participates in the setting of standards to create new business opportunities for the Healthcare, Consumer Lifestyle and Lighting sectors. A substantial portion of revenue and costs is allocated to the operating sectors. Philips believes its business as a whole is not materially dependent on any particular patent or license, or any particular group of patents and licenses.

Philips Innovation Services

Philips Innovation Services supports internal and third-party customers by offering services in concept creation support, product, process and equipment development, prototyping and small-series production, quality and reliability, sustainability, safety and health, and industry consulting.

Innovation Services is playing an increasing role in the operating sectors digital transformation, supporting the move into internet and network applications/services.

Philips Innovation Campus

Philips Innovation Campus Bangalore (PIC) hosts activities from all three operating sectors, Philips Research, IP&S and IT. Healthcare is the largest R&D organization at PIC, with activities in Imaging Systems and Patient Care &

Clinical Informatics. While PIC originally started as a software center, it has since developed into a product development center (including mechanical, electronics, and supply chain capabilities). Several Healthcare businesses have also located business organizations focusing on growth geographies at PIC.

New Venture Integration

The New Venture Integration group focuses on the integration of newly acquired companies across all sectors.

Philips Design

Philips Design partners with the Philips businesses, Group Innovation and functions to ensure that our innovations are meaningful and locally relevant, and that the Philips brand experience is preferable and consistent across all its touch-points.

Philips Design is a global function within the company, comprised of a Group Design team that drives the function and develops new competences, and fully integrated sector Design teams ensuring close alignment with the Philips businesses. The organization is made up of designers across various disciplines, as well as psychologists, ergonomists, sociologists and anthropologists all working together to understand people s needs and desires and to translate these into relevant solutions and experiences that create value for people and business. Design s forward-looking exploration projects deliver vital insights for new business development.

Philips Design is widely recognized as a leader in people-centric design. In 2012, it won over 120 key design awards in the areas of product, communication and innovation design.

Philips Healthcare Incubator

The Philips Healthcare Incubator is a dedicated corporate venturing organization within Philips. Its mission is to identify novel business opportunities based on the unmet needs of patients and their care providers, and to transform these into successful business ventures. It focuses on breakaway solutions to these unmet needs in areas that are of strategic interest to Philips. The ultimate goal is to create breakthrough businesses for Philips in health care.

6.4.2 2012 financial performance

Key data
in millions of euros unless otherwise stated

	2010	2011	2012
Sales	630	474	410
Sales growth			
% increase (decrease), nominal	14	(25)	(14)
% increase (decrease), comparable[1)]	14	(11)	(7)
Adjusted IFO of:			
Group Innovation	(84)	(51)	(122)
IP Royalties	258	198	179
Group and Regional costs	(142)	(134)	(154)
Accelerate! investment		(28)	(128)
Pensions	100	(23)	48
Service Units and other	(112)	(169)	(494)
Adjusted IFO[1)]	20	(207)	(671)

IFO	14	(217)	(679)
Net operating capital (NOC)[1)]	(3,399)	(3,895)	(4,521)
Cash flows before financing activities[1)]	(542)	(1,295)	(1,044)
Employees (FTEs)	11,929	12,474	11,492

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2012, sales amounted to EUR 410 million, EUR 64 million lower than in 2011, attributable to the divestment of Assembléon in 2011 as well as lower royalty income.

Adjusted IFO in 2012 amounted to a loss of EUR 671 million, compared to a loss of EUR 207 million in 2011. The year-on-year decrease in Adjusted IFO was largely attributable to a EUR 313 million fine issued by the European Commission in relation to the alleged violation of competition rules in the Cathode-Ray Tube (CRT) industry and provisions related to various legal matters totaling EUR 132 million. Restructuring and acquisition-related charges amounted to EUR 56 million in 2012, compared to EUR 23 million in 2011.

Adjusted IFO at Group Innovation was EUR 71 million lower than in 2011, attributable to new innovation and design initiatives, as well as higher investments in new value spaces.

Group & Regional Overhead costs were EUR 20 million higher than in 2011, mainly due to increased costs related to strengthening the market access and growth initiatives.

Accelerate! investments amounted to EUR 128 million in 2012, and include investments in IT infrastructure, internal departments and external consultancy dedicated to the Accelerate! program.

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Adjusted IFO at Pensions was EUR 71 million higher than in 2011, mainly due to the effect of lower interest rates. In 2011, Adjusted IFO was positively impacted by a EUR 21 million gain due to a plan change in one of our major plans, while 2012 was positively impacted by a EUR 25 million gain from a change in a medical retiree plan.

Adjusted IFO at Service Units and Other decreased from a loss of EUR 169 million in 2011 to a loss of EUR 494 million. The decrease was largely attributable to the CRT fine of EUR 313 million and provisions related to various legal matters totaling EUR 132 million, partly offset by a gain on the sale of High Tech Campus of EUR 37 million and lower stranded costs from the divestment of our Television business.

Net operating capital decreased to negative EUR 4,521 million, primarily related to an increase in payables and provisions due to legal and environmental matters.

Cash flows before financing activities improved from an outflow of EUR 1,295 million in 2011 to an outflow of EUR 1,044 million, mainly attributable to higher cash inflows from the sale of fixed assets.

2011 financial performance

In 2011, sales were EUR 156 million lower than in 2010, mainly due to the divestment of Assembléon in the first quarter of 2011 as well as lower royalty income.

Adjusted IFO in 2011 amounted to a loss of EUR 207 million, compared to a gain of EUR 20 million in 2010. The year-on-year decrease in Adjusted IFO was mainly attributable to lower royalty income, one-time pension items and investments related to the Accelerate! program.

Adjusted IFO at Group Innovation was EUR 33 million higher than in 2010, attributable to one-time gains from sales in research and a continuous focus on cost efficiency.

Adjusted IFO at IP Royalties was EUR 60 million lower than in 2010, attributable to the impact of one-time settlements on Optical licensing in the first quarter of 2010.

Group & Regional costs were EUR 8 million lower than in 2010, mainly attributable to cost-saving programs.

Accelerate! investments amounted to EUR 28 million in 2011, and include investments in IT infrastructure, internal departments and external consultancy dedicated to the Accelerate! program, our multi-year change and performance initiative.

Adjusted IFO at Pensions was EUR 123 million lower than in 2010, in part due to that year s EUR 119 million curtailment gain, partly offset by a EUR 21 million gain in 2011, due to a plan change in one of our major plans.

Adjusted IFO at Service Units and other decreased from a loss of EUR 112 million in 2010 to a loss of EUR 169 million. The decrease was largely attributable to legal and environmental provisions related to discount rate changes.

Net operating capital declined to negative EUR 3.895 billion, attributable to increased pension liabilities, mark-to-market changes in the group s financial hedging instruments, and sales of tangible fixed assets.

Cash flows before financing activities decreased from an outflow of EUR 542 million in 2010 to an outflow of EUR 1,295 million, mainly attributable to higher cash outflows for taxes and pensions, as well as decreased cash inflows from sales of investments.

7 Risk management

7.1 Our approach to risk management and business control

The following section presents an overview of Philips approach to risk management and business controls and a description of the nature and the extent of its exposure to risks. Philips risk management focuses on the following risk categories: Strategic, Operational, Compliance and Financial risks. These categories are further described in section 7.2, Risk categories and factors, of this report. The risk overview highlights the main risks known to Philips, which could hinder it in achieving its strategic and financial business objectives. The risk overview may, however, not include all the risks that may ultimately affect Philips. Some risks not yet known to Philips, or currently believed not to be material, could ultimately have a major impact on Philips businesses, objectives, revenues, income, assets, liquidity or capital resources.

All oral and written forward-looking statements made on or after the date of this Annual Report and attributable to Philips are expressly qualified in their entirety by the factors described in the cautionary statement included in Forward-looking statements, of this report and the overview of risk factors described in section 7.2, Risk categories and factors, of this report.

Our business, financial condition and results of operations could suffer material adverse effects due to certain risks. We have described below the main risks known to Philips and summarized them in four categories: Strategic risks, Operational risks, Compliance risks, and Financial risks.

Risk management forms an integral part of the business planning and review cycle. The company s risk and control policy is designed to provide reasonable assurance that objectives are met by integrating management control into the daily operations, by ensuring compliance with legal requirements and by safeguarding the integrity of the company s financial reporting and its related disclosures. It makes management responsible for identifying the critical business risks and for the implementation of fit-for-purpose risk responses. Philips risk management approach is embedded in the areas of corporate governance, Philips Business Control Framework and Philips General Business Principles.

Corporate governance

Corporate governance is the system by which a company is directed and controlled. Philips believes that good corporate governance is a critical factor in achieving business success. Good corporate governance derives from, amongst other things, solid internal controls and high ethical standards.

The quality of Philips systems of business controls and the findings of internal and external audits are reported to and discussed by the Audit Committee of the Supervisory Board. Internal auditors monitor the quality of the business controls through risk-based operational audits, inspections of financial reporting controls and compliance audits. Audit committees at corporate level (Group, Finance, Innovation and IT), at Global Market level and at Sector level (Healthcare, Lighting, Consumer Lifestyle, Innovation, Group & Services) meet quarterly to address weaknesses in the business controls infrastructure as reported by internal and external auditors or revealed by self-assessment of management, and to take corrective action where necessary. These audit committees are also involved in determining the desired company-wide internal audit planning as approved by the Audit Committee of the Supervisory Board. An in-depth description of Philips corporate governance structure can be found in chapter 11, Corporate governance, of this report.

Philips Business Control Framework

The Philips Business Control Framework (BCF), derived from the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework on internal control, sets the standard for risk management and business control in Philips. The objectives of the BCF are to maintain integrated management control of the company s operations, in order to ensure the integrity of the financial reporting, as well as compliance with laws and regulations.

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As part of the BCF, Philips has implemented a global standard for internal control over financial reporting (ICS). The ICS, together with Philips established accounting procedures, is designed to provide reasonable assurance that assets are safeguarded, that the books and records properly reflect transactions necessary to permit preparation of financial statements, that policies and procedures are carried out by qualified personnel and that published financial statements are properly prepared and do not contain any material misstatements. ICS has been deployed in all main reporting units, where business process owners perform an extensive number of controls, document the results each quarter, and take corrective action where necessary. ICS supports sector and functional management in a quarterly cycle of assessment and monitoring of its control environment. The findings of management s evaluation are reported to the Executive Committee and the Supervisory Board quarterly.

As part of the Annual Report process, management s accountability for business controls is enforced through the formal issuance of a Statement on Business Controls and a Letter of Representation by sector and functional management to the Executive Committee. Any deficiencies noted in the design and operating effectiveness of controls over financial reporting which were not completely remediated are evaluated at year-end by the Executive Committee. The Executive Committee s report, including its conclusions regarding the effectiveness of internal control over financial reporting, can be found in section 12.1, Management s report on internal control, of this report.

Philips General Business Principles

The Philips General Business Principles (GBP) govern Philips business decisions and actions throughout the world, applying to corporate actions and the behavior of individual employees. They incorporate the fundamental principles within Philips for doing business. The intention of the GBP is to ensure compliance with laws and regulations, as well as with Philips norms and values.

The GBP are available in most of the local languages and are an integral part of the labor contracts in virtually all countries where Philips has business activities. Responsibility for compliance with the principles rests primarily with the management of each business. Every country organization and each main production site has a compliance officer. All compliance officers operate under the supervision of the GBP Review Committee. Confirmation of compliance with the GBP is an integral part of the annual Statement on Business Controls that has to be issued by the management of each business unit.

The GBP incorporate a whistleblower policy, standardized complaint reporting and a formal escalation procedure.

The global implementation of the One Philips Ethics hotline seeks to ensure that alleged violations are registered and dealt with consistently within a company-wide system. To drive the practical deployment of the GBP, a set of directives has been published, which are applicable to all employees. There are also separate directives which apply to specific categories of employees (e.g. the Supply Management Code of Ethics and Financial Code of Ethics, refer to www.philips.com/gbp).

To seek to ensure compliance with the highest standards of transparency and accountability by all employees performing important financial functions, the Financial Code of Ethics contains, amongst other things, standards to promote honest and ethical conduct, as well as full, accurate and timely disclosure procedures in order to avoid conflicts of interest.

Both the Finance and Supply Management Code of Ethics are signed on an annual basis by the relevant employees, to confirm their awareness of and compliance with, the respective codes.

In 2012 a global internal communications program was launched in support of the roll out of the updated version of the GBP Directives and the Philips Whistleblower Policy, reflecting the effect of recent developments in the area of business ethics (UK Bribery Act, Dodd-Frank Act, UN Guiding Principles on Human Rights). This communication program, addressing the 5,000 highest-ranking employees, was developed to support local management in their communications about the updated GBP Directives, thereby ensuring a consistent tone at the top . Moreover, GBP dilemma training was provided for Philips Executives, while the 5,000 highest-ranking employees were enrolled on a dedicated GBP e-training course. The GBP dilemma training tool has been made available to all GBP Compliance Officers in support of local training activities.

The GBP self-assessment process is fully embedded in an automated workflow application (ICS) supporting Sector, Market and functional management in monitoring internal controls. Management of reporting entities are required to answer these questions before year-end and report their findings. Embedding GBP self-assessments in ICS seeks to ensure that GBP compliance is now part of Sector, Market and functional management s quarterly ICS/SOx (Sarbanes-Oxley) monitoring process, and that

GBP non-compliance issues, if significant, are reported to the Board of Management/Executive Committee via the Quarterly Certification Statement process.

In the course of 2012 significant progress was made with the roll-out of dedicated anti-corruption programs targeted at our dealers, agents and distributors:

- Implementation of a harmonized Due Diligence Process (DDP) across Sectors and Markets, supported by a dedicated global DDP program office, with specific focus on selected geographies such as Latin America, Eastern Europe, Asia and China
- Ongoing alignment between Sectors on DDP execution through a One Philips contract management system
- Continuous training to promote an understanding among all relevant stakeholders of the One Philips DDP for selecting distributors and agents

For further details, please refer to the General Business Principles paragraph in chapter 14, Sustainability statements, of this report.

Financial Code of Ethics

The Company recognizes that its businesses have responsibilities within the communities in which they operate. The Company has a Financial Code of Ethics which applies to the CEO (the principal executive officer) and CFO (the principal financial and principal accounting officer), and to the heads of the Corporate Control, Corporate Treasury, Corporate Fiscal and Corporate Internal Audit departments of the Company. The Company has published its Financial Code of Ethics within the investor section of its website located at www.philips.com. No changes have been made to the Code of Ethics since its adoption and no waivers have been granted therefrom to the officers mentioned above in 2012.

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7.2 Risk categories and factors

Taking risks is an inherent part of entrepreneurial behavior. A structured risk management process allows management to take risks in a controlled manner. In order to provide a comprehensive view of Philips business activities, risks and opportunities are identified in a structured way combining elements of a top-down and bottom-up approach. Risks are reported on a regular basis as part of the Business Performance Management process. All relevant risks and opportunities are prioritized in terms of impact and likelihood, considering quantitative and/or qualitative aspects. The bottom-up identification and prioritization process is supported by workshops with the respective management at Sector, Market and Corporate Function level. The top-down element allows potential new risks and opportunities to be discussed at management level and included in the subsequent reporting process, if found to be applicable. Reported risks and opportunities are analyzed for potential cumulative effects and are aggregated at Sector, Market and Corporate level. Philips has a structured risk management process to address different risk categories: Strategic, Operational, Compliance and Financial risks.

Strategic risks and opportunities may affect Philips strategic ambitions. Operational risks include adverse unexpected developments resulting from internal processes, people and systems, or from external events that are linked to the actual running of each business (examples are solution and product creation, and supply chain management). Compliance risks cover unanticipated failures to implement, or comply with, appropriate laws, regulations, policies and procedures. Within the area of Financial risks, Philips identifies risks related to Treasury, Accounting and reporting, Pensions and Tax. Philips does not classify these risk categories in order of importance.

Philips describes the risk factors within each risk category in order of Philips current view of expected significance, to give stakeholders an insight into which risks and opportunities it considers more prominent than others at present. The risk overview highlights the main risks and opportunities known to Philips, which could hinder it in achieving its strategic and financial business objectives. The risk overview may, however, not include all the risks that may ultimately affect Philips. Describing risk factors in their order of expected significance within each risk category does not mean that a lower listed risk factor may not have a material and adverse impact on Philips business, strategic objectives, revenues, income, assets, liquidity, capital resources or achievement of Philips Accelerate! mid-term 2013 goals. Furthermore, a risk factor described after other risk factors may ultimately prove to have more significant adverse consequences than those other risk factors. Over time Philips may change its view as to the relative significance of each risk factor.

7.3 Strategic risks

As Philips business is global, its operations are exposed to economic and political developments in countries across the world that could adversely impact its revenues and income.

Philips business environment is influenced by conditions in the domestic and global economies. Continued concerns about the macroeconomic environment has shown its impact on global financial markets during 2012. It is clear that the Eurozone crisis and the fiscal problems in the US are still far from being resolved and political stability and international cooperation remain major drivers to make further progress. The current macroeconomic situation and the economic policies in developed economies continue to point towards reduced levels of capital expenditures in general, continued pressure on consumer and business confidence and increasing unemployment in certain countries. Political developments, such as healthcare reforms in various countries (e.g. the US Healthcare Reform) may impose additional uncertainties by redistributing sector spending, changing reimbursement models and fiscal changes.

Numerous other factors, such as the fluctuation of energy and raw material prices, as well as global political conflicts in North Africa, the Middle East and other regions, could continue to impact macroeconomic factors and the international capital and credit markets. Economic and political uncertainty may have a material adverse impact on Philips financial condition or results of operations and can also make it more difficult for Philips to budget and forecast accurately. Philips may encounter difficulty in planning and managing operations due to unfavorable political factors, including unexpected legal or regulatory changes such as foreign exchange import or export controls, increased healthcare regulation, nationalization of assets or restrictions on the repatriation of returns from foreign investments and the lack of adequate infrastructure. Given that growth geographies are becoming increasingly important in Philips operations, the above-mentioned risks are also expected to grow and could have a material adverse effect on Philips financial condition and operating results.

Philips may be unable to adapt swiftly to changes in industry or market circumstances, which could have a material adverse impact on its financial condition and results.

Fundamental shifts in the industry, like the transition from traditional lighting to LED lighting, may drastically change the business environment. If Philips is unable to recognize these changes in good time, is too inflexible to rapidly adjust its business models, or if circumstances arise, such as pricing actions by competitors, then could have a material adverse effect on Philips growth ambitions financial condition and operating result.

Philips overall performance in the coming years is dependent on realizing its growth ambitions in growth geographies.

Growth geographies are becoming increasingly important in the global market. In addition, Asia is an important production, sourcing and design center for Philips. Philips faces strong competition to attract the best talent in tight labor markets and intense competition from local companies as well as other global players for market share in growth geographies. Philips needs to maintain and grow its position in growth geographies, invest in local talents, understand developments in end-user preferences and localize the portfolio in order to stay competitive. If Philips fails to achieve this, then could have a material adverse effect on growth ambitions financial condition and operating result.

Philips may not control joint ventures or associated companies in which it invests, which could limit the ability of Philips to identify and manage risks.

Philips has invested or will invest in joint ventures or associated companies in which Philips will have a non-controlling interest (e.g. TP Vision). In these cases , Philips has limited influence over, and limited or no control of, the governance, performance and cost of operations of joint ventures or associated companies. Some of these joint ventures or associated companies may represent significant investments. The joint ventures and associated companies that Philips does not control may make business, financial or investment decisions contrary to Philips interests or decisions different from those which Philips itself may have made. Additionally, Philips partners or members of a joint venture or associated company may not be able to meet their financial or other obligations, which could expose Philips to additional financial or other obligations, as well as a material adverse affect on the value of its investments in those entities or potentially subject Philips to additional claims.

Acquisitions could expose Philips to integration risks and challenge management in continuing to reduce the complexity of the company.

Philips acquisitions may continue to expose Philips in the future to integration risks in areas such as sales and service force integration, logistics, regulatory compliance, information technology and finance. Integration difficulties and complexity may adversely impact the realization of an increased contribution from acquisitions.

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7 Risk management 7.3 - 7.4

Philips may incur significant acquisition, administrative and other costs in connection with these transactions, including costs related to the integration of acquired businesses.

Furthermore, organizational simplification and resulting cost savings may be difficult to achieve. Acquisitions may also lead to a substantial increase in long-lived assets, including goodwill. Write-downs of these assets due to unforeseen business developments may have a material adverse affect on Philips earnings, particularly in Healthcare and Lighting which have significant amounts of goodwill (see also note 9, Goodwill).

Philips inability to secure and retain intellectual property rights for products, whilst maintaining overall competitiveness, could have a material adverse effect on its results.

Philips is dependent on its ability to obtain and retain licenses and other intellectual property (IP) rights covering its products and its design and manufacturing processes. The IP portfolio is the result of an extensive patenting process that could be influenced by a number of factors, including innovation. The value of the IP portfolio is dependent on the successful promotion and market acceptance of standards developed or co-developed by Philips. This is particularly applicable to Consumer Lifestyle where third-party licenses are important and a loss or impairment could have a material adverse impact on Philips financial condition and operating results.

7.4 Operational risks

Failure to deliver on the objectives of the transformation programs.

In 2011 Philips has started a very extensive transformation program (Accelerate!) to unlock Philips full potential. Accelerate! spans a time period of several years. Failure to achieve the objectives of the transformation programs may have a material adverse effect on the mid and long term financial targets.

Failure to achieve improvements in Philips solution and product creation process and/or increased speed in innovation-to-market could hamper Philips profitable growth ambitions.

Further improvements in Philips solution and product creation process, ensuring timely delivery of new solutions and products at lower cost and upgrading of customer service levels to create sustainable competitive advantages, are important in realizing Philips profitable growth ambitions. The emergence of new low-cost competitors, particularly in Asia, further underlines the importance of improvements in the product creation process. The success of new solution and product creation, however, depends on a number of factors, including timely and successful completion of development efforts, market acceptance, Philips ability to manage the risks associated with new products and production ramp-up issues, the availability of products in the right quantities and at appropriate costs to meet anticipated demand and the risk that new products and services may have quality or other defects in the early stages of introduction. Accordingly, Philips cannot determine in advance the ultimate effect that new solutions and product creations will have on its financial condition and operating results. If Philips fails to accelerate its innovation-to-market processes and fails to ensure that end-user insights are fully captured and translated into solution and product creations that improve product mix and consequently contribution, it may face an erosion of its market share and competitiveness, which could have a material adverse affect on its financial condition and operating results.

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If Philips is unable to ensure effective supply chain management, e.g. facing an interruption of its supply chain, including the inability of third parties to deliver parts, components and services on time, and if it is subject to rising raw material prices, it may be unable to sustain its competitiveness in its markets.

Philips is continuing the process of creating a leaner supply base with fewer suppliers, while maintaining dual sourcing strategies where possible. This strategy very much requires close cooperation with suppliers to enhance, amongst other things, time to market and quality. In addition, Philips is continuing its initiatives to reduce assets through outsourcing. These processes may result in increased dependency. Although Philips works closely with its suppliers to avoid supply-related problems, there can be no assurance that it will not encounter supply problems in the future or that it will be able to replace a supplier that is not able to meet its demand. Shortages or delays could materially harm its business.

Most of Philips activities are conducted outside of the Netherlands, and international operations bring challenges. For example, production and procurement of products and parts in Asian countries are increasing, and this creates a risk that production and shipping of products and parts could be interrupted by a natural disaster, such as occurred in Japan in 2011. A general shortage of materials, components or subcomponents as a result of natural disasters also bears the risk of unforeseeable fluctuations in prices and demand, which could have a material adverse affect on its financial condition and operating results.

Sectors purchase raw materials including so-called rare earth metals, copper, steel, aluminum and oil, which exposes them to fluctuations in energy and raw material prices. In recent times, commodities have been subject to volatile markets, and such volatility is expected to continue. If we are not able to compensate for our increased costs or pass them on to customers, price increases could have a material adverse impact on Philips results. In contrast, in times of falling commodity prices, Philips may not fully profit from such price decreases as Philips attempts to reduce the risk of rising commodity prices by several means, such as long-term contracting or physical and financial hedging. In addition to the price pressure that Philips may face from our customers expecting to benefit from falling commodity prices or adverse market conditions, this could also adversely affect its financial condition and operating results.

Diversity in information technology (IT) could result in ineffective or inefficient business management. IT outsourcing and off-shoring strategies could result in complexities in service delivery and contract management. Furthermore, we observe a global increase in IT security threats and higher levels of professionalism in computer crime, posing a risk to the confidentiality, availability and integrity of data and information.

Philips is engaged in a continuous drive to create a more open, standardized and consequently, more cost-effective IT landscape. This is leading to an approach involving further outsourcing, off-shoring, commoditization and ongoing reduction in the number of IT systems. This could introduce additional risk with regard to the delivery of IT services, the availability of IT systems and the scope and nature of the functionality offered by IT systems. The global increase in security threats and higher levels of professionalism in computer crime have increased the importance of effective IT security measures, including proper identity management processes to protect against unauthorized systems access. Nevertheless, Philips systems, networks, products, solutions and services remain potentially vulnerable to attacks, which could potentially lead to the leakage of confidential information, improper use of its systems and networks or defective products, which could in turn materially adversely affect Philips financial condition and operating results. In recent years, the risks that we and other companies face from cyber attacks have increased significantly. The objectives of these cyber attacks vary widely and may include, among things, disruption of operations including provision of services to customers or theft of intellectual property or other sensitive information belonging to us or other business partners. Successful cyber attacks may result in substantial costs and other negative consequences, which may include, but are not limited to, lost revenues, reputational damage, remediation costs, and other liabilities to customers and partners. Furthermore, enhanced protection measures can involve significant costs. Although we have experienced cyber attacks but to date have not incurred any significant damage as a result, there can be no assurance that in the future Philips will be as successful in avoiding damages from cyber attacks. Additionally, the integration of new companies and successful outsourcing of business processes are highly dependent on secure and well-controlled IT systems.

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Due to the fact that Philips is dependent on its personnel for leadership and specialized skills, the loss of its ability to attract and retain such personnel would have an adverse effect on its business.

The attraction and retention of talented employees in sales and marketing, research and development, finance and general management, as well as of highly specialized technical personnel, especially in transferring technologies to low-cost countries, is critical to Philips success. This is particularly valid in times of economic recovery. The loss of specialized skills could also result in business interruptions. There can be no assurance that Philips will continue to be successful in attracting and retaining all the highly qualified employees and key personnel needed in the future.

Warranty and product liability claims against Philips could cause Philips to incur significant costs and affect Philips results as well as its reputation and relationships with key customers.

Philips is from time to time subject to warranty and product liability claims with regard to product performance and effects. Philips could incur product liability losses as a result of repair and replacement costs in response to customer complaints or in connection with the resolution of contemplated or actual legal proceedings relating to such claims. In addition to potential losses arising from claims and related legal proceedings, product liability claims could affect Philips reputation and its relationships with key customers (both customers for end products and customers that use Philips products in their production process). As a result, product liability claims could materially impact Philips financial condition and operating results.

Any damage to Philips reputation could have an adverse effect on its businesses.

Philips is exposed to developments which could affect its reputation. Such developments could be of an environmental or social nature, or connected to the behavior of individual employees or suppliers and could relate to adherence to regulations related to labor, health and safety, environmental and chemical management. Reputational damage could materially impact Philips financial condition and operating results.

7.5 Compliance risks

Legal proceedings covering a range of matters are pending in various jurisdictions against Philips and its current and former group companies. Due to the uncertainty inherent in legal proceedings, it is difficult to predict the final outcome.

Philips, including a certain number of its current and former group companies, is involved in legal proceedings relating to such matters as competition issues, commercial transactions, product liability, participations and environmental pollution. Since the ultimate outcome of asserted claims and proceedings, or the impact of any claims that may be asserted in the future, cannot be predicted with certainty, Philips financial position and results of operations could be affected materially by adverse outcomes.

Please refer to note 25, Contingent liabilities, for additional disclosure relating to specific legal proceedings.

Philips is exposed to governmental investigations and legal proceedings with regard to increased scrutiny of possible anti-competitive market practices.

Philips is facing increased scrutiny by national and European authorities of possible anti-competitive market practices, especially in product segments where Philips has significant market shares. For example, Philips and certain of its (former) affiliates are involved in investigations by competition law authorities in several jurisdictions into possible anti-competitive activities in the Cathode-Ray Tubes (CRT) industry and are engaged in litigation in this respect. Philips financial position and results could be materially affected by an adverse final outcome of these investigations and litigation, as well as any potential claims relating to this matter. Furthermore, increased scrutiny may hamper planned growth opportunities provided by potential acquisitions (see also note 25, Contingent liabilities).

Philips global presence exposes the company to regional and local regulatory rules which may interfere with the realization of business opportunities and investments in the countries in which Philips operates.

Philips has established subsidiaries in over 80 countries. These subsidiaries are exposed to changes in governmental regulations and unfavorable political developments, which may limit the realization of business opportunities or impair Philips local investments. Philips increased focus on the healthcare sector increases its exposure to highly regulated markets, where obtaining clearances or approvals for new products is of great importance, and the dependency on the funding available for healthcare systems. In addition, changes in reimbursement policies may affect spending on healthcare.

Philips is exposed to non-compliance with General Business Principles.

Philips attempts to realize its growth targets could expose it to the risk of non-compliance with the Philips General Business Principles, in particular anti-bribery provisions. This risk is heightened in growth geographies as corporate governance systems, including information structures and the monitoring of ethical standards, are less developed in growth geographies compared to mature geographies. Examples include commission payments to third parties, remuneration payments to agents, distributors, commissioners and the like, and the acceptance of gifts, which may be considered in some markets to be normal local business practice. (See also note 25, Contingent liabilities.)

Defective internal controls would adversely affect our financial reporting and management process.

The reliability of reporting is important in ensuring that management decisions for steering the businesses and managing both top-line and bottom-line growth are based on top-quality data. Flaws in internal control systems could adversely affect the financial position and results and hamper expected growth.

The correctness of disclosures provides investors and other market professionals with significant information for a better understanding of Philips businesses. Imperfections or lack of clarity in the disclosures could create market uncertainty regarding the reliability of the data presented and could have a negative impact on the Philips share price.

The reliability of revenue and expenditure data is key for steering the business and for managing top-line and bottom-line growth. The long lifecycle of healthcare sales, from order acceptance to accepted installation, together with the complexity of the accounting rules for when revenue can be recognized in the accounts, presents a challenge in terms of ensuring there is consistency of application of the accounting rules throughout Philips Healthcare s global business.

Philips is exposed to non-compliance with data privacy and product safety laws.

Philips brand image and reputation would be adversely impacted by non-compliance with the various (patient) data protection and (medical) product security laws. In particular, Philips Healthcare is subject to various data protection and safety laws. Privacy and product safety and security issues may arise, especially with respect to remote access or monitoring of patient data or loss of data on our customers systems, although Philips Healthcare contractually limits liability, where permitted.

Philips operates in a highly regulated product safety and quality environment. Philips products are subject to regulation by various government agencies, including the FDA (US) and comparable foreign agencies. Obtaining their approval is costly and time consuming, but a prerequisite for market introduction. A delay or inability to obtain the necessary regulatory approvals for new products could have a material adverse effect on business. The risk exists that product safety incidents or user concerns could trigger FDA business reviews which, if failed, could lead to business interruption which in turn could adversely affect Philips financial condition and operating results.

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7.6 Financial risks

Philips is exposed to a variety of treasury risks including liquidity risk, currency risk, interest rate risk, commodity price risk, credit risk, country risk and other insurable risk.

Negative developments impacting the global liquidity markets could affect the ability of Philips to raise or refinance debt in the capital markets or could lead to significant increases in the cost of such borrowing in the future. If the markets expect a downgrade or downgrades by the rating agencies or if such a downgrade has actually taken place, it could increase the cost of borrowing, reduce our potential investor base and adversely affect our business.

Philips is exposed to fluctuations in exchange rates, especially between the US dollar and the euro. A high percentage of its business volume is conducted in the US but based on exports from Europe, whilst, a considerable amount of US dollar denominated imports is also sold in Europe. A weakening of the US dollar versus the euro would have an adverse effect on reported earnings of the company. In addition, Philips is exposed to the fluctuation in exchange rates of other currencies such as the Japanese yen and currencies of growth geographies such as China, India and Brazil.

The credit risk of financial and non-financial counterparties with outstanding payment obligations creates exposures for Philips, particularly in relation to accounts receivable with customers and liquid assets and fair values of derivatives and insurance receivables contracts with financial counterparties. A default by counterparties in such transactions can have a material adverse effect on Philips financial condition and operating results.

Philips supply chain is exposed to fluctuations in energy and raw material prices. Commodities such as oil are subject to volatile markets and significant price increases from time to time. If Philips is not able to compensate for, or pass on, its increased costs to customers, such price increases could have an adverse impact on its financial condition and operating results.

Philips is exposed to interest rate risk, particularly in relation to its long-term debt position; this risk can take the form of either fair value or cash flow risk. Failure to effectively hedge this risk can impact Philips financial condition and operating results.

For further analysis, please refer to note 34, Details of treasury risks.

Philips is exposed to a number of different fiscal uncertainties which could have a significant impact on local tax results.

Philips is exposed to a number of different tax uncertainties which could result in double taxation, penalties and interest payments. These include transfer pricing uncertainties on internal cross-border deliveries of goods and services, tax uncertainties related to acquisitions and divestments, tax uncertainties related to the use of tax credits and permanent establishments, tax uncertainties due to losses carried forward and tax credits carried forward and potential changes in tax law that could result in higher tax expense and payments. Those uncertainties may have a significant impact on local tax, results which in turn could adversely affect Philips financial condition and operating results.

The value of the losses carried forward is subject to having sufficient taxable income available within the loss-carried-forward period, but also to having sufficient taxable income within the foreseeable future in the case of losses carried forward with an indefinite carry-forward period. The ultimate realization of the Company s deferred tax assets, including tax losses and credits carried forward, is dependent upon the generation of future taxable income in the countries where the temporary differences, unused tax losses and unused tax credits were incurred and during the periods in which the deferred tax assets become deductible. Additionally, in certain instances, realization of such deferred tax assets is dependent upon the successful execution of tax planning strategies. Accordingly, there can be no absolute assurance that all (net) tax losses and credits carried forward will be realized.

For further details, please refer to the fiscal risks paragraph in note 3, Income taxes.

Philips has defined-benefit pension plans in a number of countries. The funded status and the cost of maintaining these plans are influenced by movements in financial market and demographic developments, creating volatility in Philips financials.

The majority of employees in Europe and North America are covered by defined-benefit pension plans. The accounting for defined-benefit pension plans requires management to make estimates on discount rates, inflation, longetivity and expected rates of compensation. Changes in these assumptions can have a significant impact on the projected benefit obligations and net periodic pension costs. A negative performance of the financial

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markets could have a material impact on cash funding requirements and net periodic pension costs and also affect the value of certain financial assets and liabilities of the company.

For further details, please see note 29, Pensions and other postretirement benefits.

Philips is exposed to a number of reporting risks.

A risk rating is assigned for each risk identified, based on the likelihood of occurrence and the potential impact of the risk on the financial statements and related disclosures. In determining the probability that a risk will result in a misstatement of a more than inconsequential amount or material nature, the following factors are considered to be critical: complexity of the associated accounting activity or transaction process, history of accounting and reporting errors, likelihood of significant (contingent) liabilities arising from activities, exposure to losses, existence of a related party transaction, volume of activity and homogeneity of the individual transactions processed and changes to the prior period in accounting characteristics compared to the previous period.

Important critical reporting risk areas identified within Philips following the risk assessment are:

- complex accounting for sales-related accruals, warranty provisions, tax assets and liabilities, pension benefits, and business combinations
- complex sales transactions relating to multi-element deliveries (combination of goods and services)
- valuation procedures with respect to assets (including goodwill and inventories)
- past experience of control failures relating to segregation of duties
- significant (contingent) liabilities such as environmental claims and other litigation
- outsourcing of high volume/homogeneous transactional finance and IT operations to third-party service providers

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8 Management

Koninklijke Philips Electronics N.V. is managed by an Executive Committee which comprises the members of the Board of Management and certain key officers from functions, businesses and markets.

The Executive Committee operates under the chairmanship of the Chief Executive Officer and shares responsibility for the deployment of