Towards Vision 2010
Focusing on people's needs in health and wellbeing

Philips publications April 2008
This publication contains the speech of Gerard Kleisterlee, President and CEO of Royal Philips Electronics, at the Annual General Meeting of Shareholders, held on March 27, 2008 in Amsterdam. In his speech, Mr. Kleisterlee reviewed the transformation of Philips into a leading Healthcare, Lighting and Consumer Electronics and explained the company’s Vision 2010 strategy going forward. Vision 2010 puts people right at the center of attention, while addressing their needs and aspirations for health and wellbeing.
Ladies and Gentlemen,

On behalf of the Board of Management, I bid you a warm welcome.

2007 was an exciting year for Philips, one in which we took significant steps forward operationally, strategically and financially.

**Simpler, better, stronger**

As the front cover of our annual report clearly expresses, Philips is getting simpler, stronger and better.

Our operational results were solid, if not spectacular. The most important thing for you is that at Group level we achieved our targets for sales growth and EBITA margin. It is always our ambition to exceed our objectives, but unfortunately we only partly succeeded in doing so in 2007.

From a strategic point of view, we have made great progress in building up our new business portfolio. In December we were able to announce – after a thorough process during which we asked for, and were given, your patience – the two largest takeovers in our Company’s recent history: Genlyte and Respironics. And with Vision 2010 we set out a clear plan for creating substantial value for our shareholders in the coming years.

In financial terms we gave a decisive impulse to the reallocation of capital with the announcement of a new share buy-back program worth 5 billion euros which we shall execute for the most part in 2008. We also sold a considerable portion of our remaining financial investments. As a result, our financial restructuring is approaching completion and a balance sheet with a healthy debt/equity ratio is within reach.

Our confidence in the strength of the Company and its finances is underlined by our proposal to increase the dividend for the fourth time in succession, this time to 70 euro cents per share.

**2007 Management agenda**

Allow me first of all to recap briefly the main
facts and figures for 2007, on the basis of our Management Agenda 2007. The first target – sales growth of 5 to 6%; EBITA margin above 7.5% – we have achieved, though comparable sales growth, at 5%, was at the low end of the bandwidth. The spectacular 15% growth in DAP was largely offset by the flat sales in Consumer Electronics. Medical Systems performed well, but had to contend with a downturn in the market for imaging systems in the United States, a consequence of the Deficit Reduction Act, while Lighting also remained slightly below its potential as a result of the sharp contraction of the market for projection lamps.

The growth of our EBITA margin from 5.2% in 2006 to 7.7% in 2007 was good, however, and puts us in an excellent position for the coming years. DAP and Lighting stood out in a positive sense here.

In my opinion we can also put a big tick against our second objective, the continued disciplined use of capital for value-creating takeovers, share buy-backs and the distribution of dividend. In our acquisition policy we have been decisive, but also patient and thorough. That was why we were able to acquire top-class companies like Genlyte and Respironics for a fair price. And we made use of the increase in the tax-free ceiling for share buy-backs to effect a new program worth 5 billion euros.

We not only made acquisitions in 2007: we also disposed of a number of businesses with low growth and low margins. Our present portfolio is balanced, also geographically, and more resistant than in the past to an economic downturn.

The Management Agenda 2007 required us to drive a culture in which everything is geared to ensuring a superior customer experience, and to introduce the Net Promoter Score throughout the Company as a metric. The Net Promoter Score measures the answer to one simple question: “How likely is it that you would recommend this company/product to a friend or colleague?” At present nearly 50% of our businesses
have a score equal to or better than our nearest competitor. We want to further raise this percentage to 70% in 2010, for a simple reason: a satisfied customer means more sales and a better margin.

The last objective in our Management Agenda 2007 related to our own employees. Our aim is to offer our employees a stimulating work environment and to bring their engagement with the Company to a high-performance benchmark level within two to three years.

We measure this in an annual survey via our Employee Engagement Index. In 2007, the
response didn’t only show an increase, the results were also appreciably better. The Engagement Index went up from 61% to 64%, a good step on the way to our objective of achieving the high-performance benchmark of 70% by 2009.

**Philips today**

Our actions in 2007 have further contributed to the strengthening of the new Philips. We have come a long way since starting in 2001 on the transformation of our Company. This exciting journey is now entering a new phase. So this is a good moment to sum up again all the changes, but above all to look ahead to the future prospects for this new Philips.

Around the turn of the century we were still a relatively volatile electronics company, vertically integrated, with a focus on technology and operating in highly cyclical markets. Today, in 2008, Philips is a completely different company. The realignment of our portfolio has been prompted by a number of fundamental insights.

Firstly we saw that the traditionally vertically integrated electronics industry was dividing up more and more into three sectors: one sector concentrating on technology, in the form of semiconductors and components; one sector focusing on the assembly of semi-manufactured and finished products for Original Equipment Manufacturers; and one sector concentrating on branded products and solutions for end users.

Secondly we ascertained that the characteristics of a technology company were clearly different to those of a company where everything revolves around the brand and the creation of solutions for end users. The pursuit of excellence meant making an unconditional choice in favor of one of the two.

Thirdly it was becoming increasingly clear that Philips was a hybrid proposition for investors: a good dose of volatile high-tech mixed with some steady growers with strong cash flows, such as Medical Systems, Lighting and DAP. At the same time we saw at the beginning of this decade a number of global
trends to which Philips would be able to respond effectively with these activities. Consequently, as we moved forward we made a clear choice to shape the Philips portfolio on the basis of our end user-orientated activities, building on the Philips brand and leveraging our strength in innovation and design. Our “sense and simplicity” brand promise plays a vital role in this. “Sense and simplicity” puts the user very much at the center of things. At a time when people increasingly regard complexity as a problem, Philips offers the prospect of creative, high-quality, but above all simple solutions. Technology, certainly, but technology in the service of people, not the other way round.
With these insights we rebuilt our portfolio. Ten years ago many people still saw Medical Systems, Lighting and DAP as peripheral areas for Philips. In the meantime we have expanded Healthcare and Lighting into essential core activities, by means of sizeable acquisitions and organic growth. We have sold Components and Semiconductors. At Consumer Electronics we have fundamentally changed our approach: everything revolves around the consumer, not around the electronics; in that regard DAP has been pointing the way for years.

Giving paramount importance to the consumer and user. Strengthening our brand. A radical realignment of our portfolio. Focusing on applications. Outsourcing a large proportion of our assembly activities. Reducing minority interests. This is the strategic transformation that Philips has undergone in the past few years, and it is now a matter of reaping the benefits.

**Vision 2010: An overall focus on health and wellbeing**

That is why last September we presented Vision 2010, our program for the coming three years aimed at creating substantial shareholder value by means of profitable growth.

With Vision 2010, we are putting people right at the center of things, with Health and Wellbeing as our overarching theme. We are thereby, in a modern and relevant fashion, putting into practice our mission: improving the quality of life through the introduction of meaningful innovations.

By ‘health’ we mean not only people’s medical condition, but also the health of our planet. And with ‘wellbeing’ we are thinking of the new consumer, who is not only concerned with enjoyment and entertainment, but also with a safe and pleasant environment, a responsible lifestyle and care for others.
Healthcare: People focused, health-care simplified

Healthcare clearly includes hospital care, but in striving for high-quality and, at the same time, affordable healthcare, an increasingly vital role will also be played by home care. We expect to see a rapidly growing need for home care in view of the ageing of the population, the high cost of hospital care and, last but not least, the wishes of patients themselves. Thanks to our knowledge and experience in the field of consumer needs we are very well placed to take a leading position in this growth market. The acquisition of Respironics, a leading global supplier of respiratory equipment and sleep
therapy solutions, both for hospitals and for the home, therefore fits into the list of previous acquisitions such as Lifeline, Healthwatch and Raytel, which are also involved in various forms of home care.

We occupy a leading position worldwide in areas such as cardiac care, acute care and home care. We shall improve our margins in Healthcare by becoming an even better partner for the various players in this field, by cutting back our costs and by enhancing our operational efficiency. We shall strengthen our position in emerging markets, for instance by offering products that are specifically targeted at these markets.
**Lighting: Leading towards the future**

In Lighting we concentrate on offering new applications which enhance wellbeing in the home, at school, in the office, in industry, in the street and while shopping. It is in the Lighting sector that our shift from products to solutions is most clearly visible. A major focus here is energy-efficient solutions in general and solid-state lighting, or LED lighting, in particular, because LEDs not only create atmosphere but also yield energy savings.

In Lighting too we have considerably strengthened our position by means of acquisitions. At the end of last year we announced the takeover of Genlyte, the main manufacturer of luminaires in the United States, after having previously acquired firms such as Color Kinetics, the leading supplier of innovative LED lighting systems. As a consequence, we are now the largest lighting company in the United States and so have further strengthened our global leadership in the market for advanced energy-saving lighting solutions.

**Consumer Lifestyle: Understanding modern consumer needs**

In Consumer Lifestyle we have developed an integrated strategy for modern consumers and their needs in relation to health and wellbeing. Our offering ranges from our Avent products for mother and baby care to products that promote a healthy lifestyle or help you to look good, along with those which enhance people’s experiences in the living room, such as the Aurea television.

We hold a number of trump cards to strengthen our position in Consumer Lifestyle: our strong global brand; our profound understanding of what consumers want; our top quality in technology and design; and our extensive network of distribution channels, partners and suppliers.

As well as many categories with excellent margins, Consumer Lifestyle also has areas where the competition is intense, such as TV. For Connected Displays in particular we will take decisive action this year to address the issue of unsatisfactory margins.
Where we are not able to create value for our shareholders we shall not participate, just as we wish to grow in market segments where we can fully exploit our strengths.

**Organized around customers and markets**

Structure follows strategy. That is why, as part of Vision 2010, we merged Consumer Electronics and Domestic Appliances & Personal Care - with effect from 1 January this year - to form a single new sector called Consumer Lifestyle. It is also the reason why we have combined Medical Systems with Home Healthcare Solutions to form Philips Healthcare. Add Philips Lighting to these and...
we have three sectors which are linked by our emphasis on people and their health and wellbeing, as well as by the Philips brand and our culture of innovation.

**Sustainability**
That is also why, in the area of sustainability, we drew up an ambitious plan – EcoVision 4 – last year. While green products accounted for roughly 20% of our sales in 2007, we want this to be about 30% in 2012. Over the coming years we are going to invest 1 billion euros in green innovation and we intend to reduce our own energy consumption by 25% over the coming five years.
In this respect it is worth noting that we have today announced our intention to take a 40% stake in a joint venture that is going to build a production and recycling plant in Lesotho, in Southern Africa. In this way we are helping the region in its effort to tackle the issue of energy and to boost the regional economy.

**Financial targets Vision 2010**

In Vision 2010 we also set specific financial targets which will strongly increase Philips’ shareholder value. It is our target for the EBITA margin of our current businesses to exceed 10% by year-end 2010. We can achieve this through improved margin management; increased contribution from previous acquisitions; a better product mix; and further cost savings on the basis of simplicity of organization and way of working.

As regards sales, our target is to drive comparable sales growth at a minimum of 6% for the period 2008 to 2010, though of course in every separate year and quarter the results will partly depend on the economic climate in our most important markets.

Together with the completion of our financial restructuring – including the share buy-back program and an efficient balance sheet by the end of 2009 – all this means that EBITA per common share in 2010 should be double the figure for 2007.

These are ambitious targets. We are convinced, however, that with hard work we can meet this challenge, unless circumstances beyond our control – for instance a multi-year period of severe economic headwind – alters the playing field.

**Total Return to Shareholders**

As you know, we have altered the group of peer companies with which we compare ourselves with regard to shareholder return, in view of the radical change in our portfolio. On the basis of the return on our shares over a period of three years – measured via the TSR score – we have nevertheless risen to 5th place within the old group of 24 peer companies. In our new peer group we are in 6th place, near the top five and well ahead of the companies below us.
It goes without saying that we attach great importance to shareholder value. Like you, we are not satisfied with our share price over the past few years. The fact that the return for our shareholders would have been somewhat lower if we had not radically transformed our Company is scant consolation. We are convinced, however, that as it becomes clear, quarter by quarter, year by year, that Philips has once and for all turned over a new leaf and is proceeding to fulfill or even exceed its greater ambitions, this can only result in a noticeably positive share price.

2008 Management agenda

Ladies and Gentlemen, what objectives has the Board of Management set itself for 2008? You will see that, following the major acquisitions, this Management Agenda 2008 is dominated by the themes of implementation and execution, and operational performance.

First of all we want to integrate and leverage the recent acquisitions to achieve the anticipated return on investment. Secondly we are going to take decisive steps to structurally deal with unsatisfactory EBITA margins at Connected Displays.

It is also our objective to improve productivity as a driver of margin expansion.

A fourth target is to step up resource investment in emerging markets in order to accelerate growth in those markets to more than twice the rate of growth of local GDP. Emerging markets like China, India, Russia and Brazil now account for roughly 30% of our sales.

Our fifth objective is to focus our innovation even more clearly on supporting Philips’ growth ambitions by spending more on totally new products and less on new variants of existing ones.

Our sixth objective is to continue to drive a culture of superior customer experience. Finally, as I have already said, we want to bring employee engagement to the high-performance benchmark level. Having the courage to operate in a more decentralized
way, leadership that is less hierarchical, less controlling and more inspiring and flexible – those are the key words in the process of change in which we are strongly engaged.

Ladies and Gentlemen, that brings me almost to the end of my speech. But before I end I would like to address an issue with which some of you will undoubtedly be preoccupied, namely the alleged real estate fraud at the Philips Pension Fund. Like you, we are shocked and concerned about everything we have heard on this subject in the media. At the same time we are comforted to know that an urgent independent investigation into this matter is taking place at present, and we sincerely hope that in the interests of all concerned no stone will be left unturned. It goes without saying that we are cooperating fully with the authorities’ investigation.

As the investigation is still ongoing I am unable to discuss this matter in further detail here. I can assure you, however, that we shall seek to limit the damage as much as possible and if possible to recover the amount of the loss. I also wish to emphasize that the Pension Fund’s funding ratio is particularly solid and that, given the total assets of the Pension Fund, the pensions of all the members are not, and will not be, jeopardized by any possible loss.

Thank you and all the best…

It only remains for me to express thanks and say farewell to some Philips colleagues who in the past years have committed their efforts to make Philips the wonderful company that it is today. First we are taking leave of Theo van Deursen, who will be retiring on April 1 this year. Over a period of 35 years Theo has made a tremendous contribution to Philips, in recent years as CEO of Philips Lighting, where he was the driving force behind the new, successful and growing Lighting sector. I wish him all the very best for this new phase in his life.

This year we are also saying farewell to Wim de Kleuver, chairman of the Supervisory Board, and to Supervisory Board member Louis Schweitzer. We have always greatly appreciated the efforts, wisdom and advice
of both these gentlemen. I wish them too, all the very best for the future.

Finally I would also like to thank you, our shareholders, for the trust you have placed in Philips. We shall do our utmost to meet your expectations. We are going to roll our sleeves up and turn Vision 2010 into Reality 2010!

Thank you for your attention.
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