KONINKLIJKE PHILIPS ELECTRONICS NV
Form 20-F
February 25, 2013

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 Euro (EUR) 0.20 per share	New York Stock Exchange

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

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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.

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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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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.

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%

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3 Our strategy in action 3 - 3

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

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 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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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.

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4 Our planet, our partners, our people

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.

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.

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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.

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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.

5 Group performance 5.1.1 - 5.1.1

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%.

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.

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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.

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

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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)