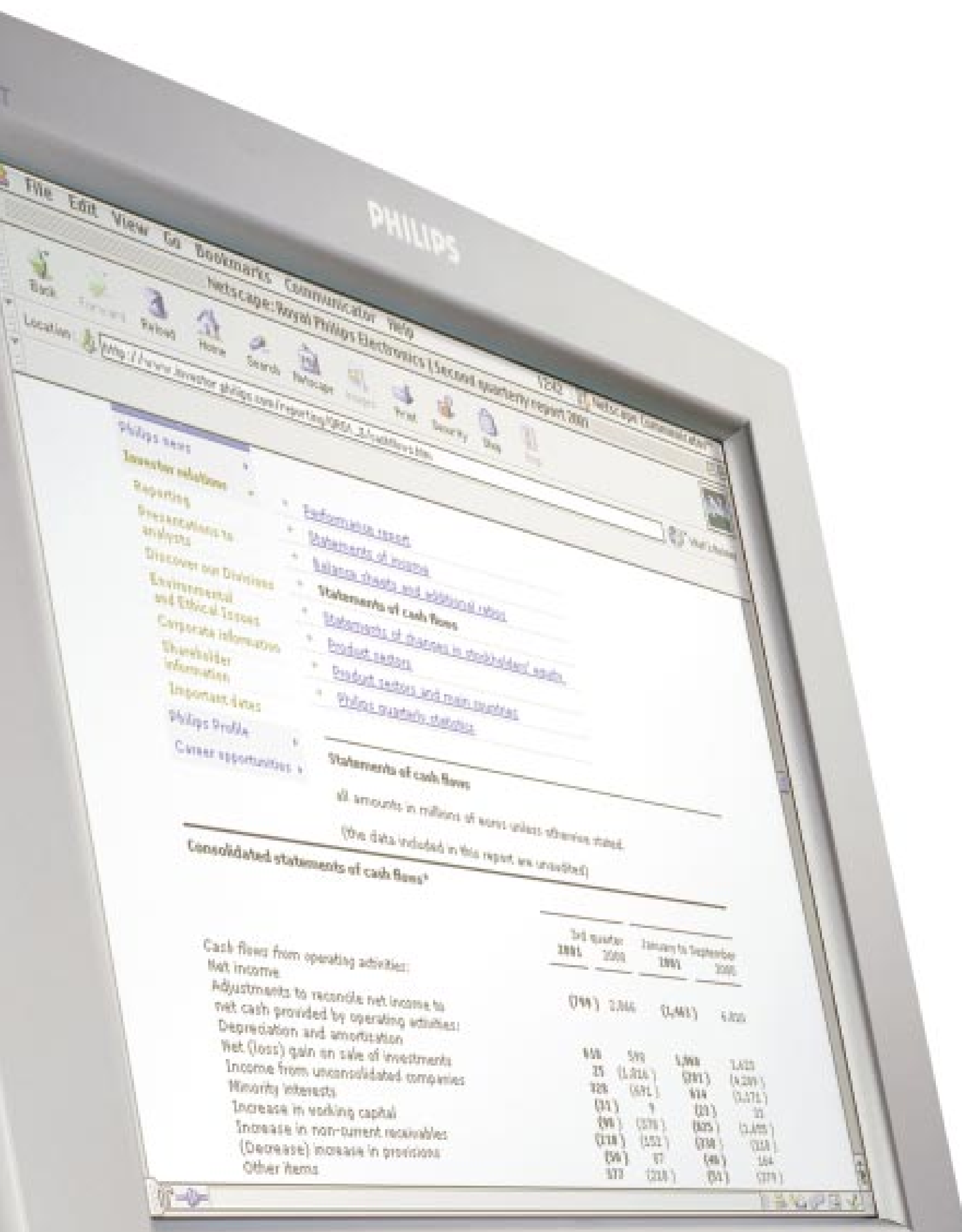
PHILIPS

Annual Report 2001

Financial Statements and Analysis



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'Safe Harbor' Statement under the Private Securities Litigation Reform Act of 1995
This document contains certain forward-lokking 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 the outlook paragraph of the 'Operating and Financial Review and Prospects' in this Financial Statements and Analysis booklet.
By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include, but are not limited to, levels of consumer and business spending in major economies, changes in consumer tastes and preferences, the levels of marketing and promotional expenditures by Philips and its competitors, raw materials and employee costs, changes in future exchange and interest rates (in particular changes in the euro and the US dollar can materially affect results), changes in tax rates and future business combinations, acquisitions or dispositions and the rate of technical changes. Market share estimates contained in this report are based on outside sources such as specialized research institutes, industry and dealer panels, etc. in combination with management estimates.

This Financial Statements and Analysis booklet and the separate booklet entitled 'Management Report' together comprise the full Annual Report for the year 2001 of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics').
For a full understanding of the results of the Philips Group and the state of affairs, both booklets should be consulted.

Financial highlights

all amounts in millions of euros unless otherwise stated

	2001	2000	1999
Sales	**32,339**	37,862	31,459
Income (loss) from operations	**(1,371)**	4,281	1,751
As a % of sales	**(4.2)**	11.3	5.6
As a % of net operating capital (RONA)	**(9.1)**	35.7	17.5
Net income (loss)	**(2,604)**	9,602	1,799
Per common share - basic	**(2.04)**	7.31	1.31
Dividend paid per common share (from prior-year profit distribution)	**0.36**	0.30	0.25
Cash flows before financing activities	**(3,316)**	592	(1,921)
Stockholders' equity	**18,453**	21,736	14,757
Per common share	**14.48**	16.93	11.08
Net debt : group equity ratio	**27:73**	12:88	6:94
Excluding special items*:			
Income (loss) from operations	**(136)**	3,211	1,736
As a % of sales	**(0.4)**	8.5	5.5
As a % of net operating capital (RONA)	**(0.9)**	26.8	17.3
Net income (loss)	**(908)**	2,831	1,614
Per common share - basic	**(0.71)**	2.16	1.17

* Special items relate to income and expenses resulting from normal business operations, which, because of their size or nature, are disclosed separately to give a better understanding of the underlying result for the period. These include items such as restructuring and impairment charges, acquisition-related charges and significant gains and losses on the disposal of businesses or participations.

Operating and Financial Review and Prospects

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

The consolidated financial statements were prepared on a basis consistent with generally accepted accounting principles in the Netherlands (Dutch GAAP). These accounting principles differ in some respects from generally accepted accounting principles in the United States (US GAAP), which differences are discussed in note 27 to the consolidated financial statements.

Special items, as presented in the Operating and Financial Review and Prospects, relate to income and expenses resulting from normal business operations, which, because of their size or nature, are disclosed separately to give a better understanding of the underlying result for the period. These include items such as restructuring and impairment charges, acquisition-related charges and significant gains and losses on the disposal of businesses or participations. In some analyses these special items have been excluded from income in order to give a better insight into the comparable performance of the Philips Group. However, the reader should note that income from continuing operations excluding special items is not a measure of financial performance as defined by Dutch or US GAAP.

The year 2001

Summary

After the record year 2000, the Company's performance in 2001 was heavily impacted by the worldwide economic downturn. The collapse of the dot.com industry engulfed the IT sector, severely affecting telecom and PC-related businesses and creating the deepest and steepest decline ever in the semiconductors and components industries. Our cyclical electronics businesses Semiconductors, Consumer Electronics and Components, as well as some of our major unconsolidated companies such as Taiwan Semiconductor Manufacturing Company (TSMC), LG.Philips LCD and LG.Philips Displays, were significantly impacted by the decline. Consumer confidence fell drastically after the tragic events of September 11 in the USA, and the manufacturing sector continued its reluctancy to make new investments.

Our Lighting, Domestic Appliances and Personal Care (DAP) and Medical Systems businesses, which operate in less cyclical markets, continued their solid performances. DAP and Medical Systems (excluding special items) recorded their best year ever.
The year 2001 was also characterized by major changes in the product portfolio as we continue to align it with our long-term strategy. The Display Components activities were transferred into a 50/50 joint venture with LG Electronics of Korea as of July 2, 2001. Additionally, decisions were taken to outsource the manufacturing and some parts of the development of mobile handsets and video recorders. Significant acquisitions were made to strengthen our Medical Systems activities. During the year, we acquired medical systems businesses from Marconi and Agilent.

Sales in 2001 amounted to EUR 32,339 million, a decrease of 15% compared to the prior year. The sales decline reflects the significant downturn in the markets for Semiconductors, Components, Mainstream CE and Consumer Communications, where substantially reduced demand and severe price erosion were encountered. The decline also reflects the deconsolidation of Display Components, which was partially offset by the increased sales resulting from acquisitions at Medical Systems and DAP. Sales at Lighting remained relatively flat. In some areas (Consumer Communications and Digital Networks) sales decreased as part of the scaling-down and refocusing strategy. In nearly all other areas, sales were virtually in line with the global market. An important positive exception was Medical Systems, whose market share was strongly uplifted by significant acquisitions, bringing the division to a No. 2 market position by year-end.

The decline in 2001 income from operations, compared to 2000, was related to the worldwide economic downturn in our markets. Inventory corrections in the PC and telecommunication industries had a major impact on the 2001 performance after excessive inventory stocking by customers during the previous year. Additionally, under-utilization of factories led to significant losses in certain businesses.

The return on net assets (RONA) decreased to a negative 9.1% in 2001, compared to a positive 35.7% in 2000 and 17.5% in 1999. Excluding special items, RONA for 2001 was 0.9% negative compared to a positive 26.8% and 17.3% in 2000 and 1999 respectively. The decrease in 2001 was primarily attributable to lower profitability.

Income from continuing operations in 2001 amounted to a loss of EUR 2,604 million (EUR 2.04 per common share-basic) compared with a profit of EUR 9,602 million (EUR 7.31 per common share-basic) in 2000 and EUR 1,804 million (EUR 1.31 per common share-basic) in 1999. The results included a number of special items, which are presented in the table below.

Income (loss) from continuing operations excluding special items:

amounts in millions of euros unless otherwise stated

	2001	2000	1999
As published	**(2,604)**	9,602	1,804
per common share-basic	**(2.04)**	7.31	1.31
Affecting income from operations:			
Restructuring and impairment charges	**(1,093)**	(197)	(86)
Acquisition-related costs incl. in-process R&D	**(437)**	(114)	(68)
Gain on sale of participations	**295**	309	169
Atos Origin merger gain		1,072	
Affecting financial income and expenses:			
Gain on sale of JDS Uniphase shares		1,207	117
Seagram/Vivendi share exchange gain, net		1,115	
Impairment Vivendi/Great Nordic shares	**(526)**		
Income taxes related to special items	**313**	(18)	(9)
Affecting results relating to unconsolidated companies:			
Gain on sale of shares and participations	**20**	2,717	
Restructuring and impairment charges	**(208)**		
Dilution (losses) and gains related to TSMC's equity transactions (see note 5 to the consolidated financial statements)	**(60)**	680	67
Excluding special items	**(908)**	2,831	1,614
per common share - basic	**(0.71)**	2.16	1.17

Cash flows provided by operating activities totaled EUR 1,248 million in 2001, compared with EUR 2,996 million in 2000 and EUR 1,913 million in 1999. The decrease in cash provided by operating activities is mainly attributable to the lower income. Significant reductions of inventory, as a result of our supply chain improvement programs, and of receivables were partly offset by lower payables. The reduction of working capital in relation to sales reflects the success of the cash conversion cycle program that was started two years ago.

In 2001 net cash used for investing activities totaled EUR 4,564 million, of which EUR 3,636 million relates to the purchase of businesses, particularly at Medical Systems, compared to EUR 2,404 million in 2000 and EUR 3,834 million in 1999.
Proceeds from the sale of businesses totaled EUR 755 million in 2001, of which the sale of the Glass activities of Components (to the newly established joint venture with LG Electronics), FEI Company and Philips Broadcast were the most important.
At EUR 2,143 million, cash requirements for capital expenditures were significantly down from the level in 2000, particularly at Semiconductors and Components as a result of overcapacity in these sectors.

Net cash provided by financing activities totaled EUR 3,159 million in 2001, compared to EUR 2,038 million net cash used in 2000. The financing needs in 2001 were met by the issuance of two tranches of two eurobonds each, totaling EUR 4,250 million. The cash requirements for financing activities in 2000 and 1999 came to EUR 2,038 million and EUR 2,606 million respectively. Both years included capital repayments to shareholders – EUR 1,673 million and EUR 1,490 million respectively – from the share reduction program.

At December 31, 2001 the Company's net debt:group equity ratio was 27:73.

Group sales and income from operations

amounts in millions of euros	**2001**	2000	1999
Sales	**32,339**	37,862	31,459
% nominal (decrease) increase	**(15)**	20	3
Income (loss) from operations	**(1,371)**	4,281	1,751
as a % of sales	**(4.2)**	11.3	5.6
Income (loss) from operations excl. special items	**(136)**	3,211	1,736
as a % of sales	**(0.4)**	8.5	5.5

The composition of the change (%) in sales over 2001 and 2000 was as follows:

	2001 versus 2000	2000 versus 1999
Consolidation changes	**(0.7)**	0.4
Currency effects	**0.1**	9.3
Prices	**(8.2)**	(5.3)
Volume	**(5.8)**	16.0
Nominal change	**(14.6)**	20.4

Sales in 2001 decreased by 15% compared with the previous year. Changes in consolidations had a minor negative effect, with the decline caused by the deconsolidation of Display Components into a 50/50 joint venture with LG Electronics slightly exceeding the increase from various consolidations, particularly ADAC and the medical systems businesses of Agilent HSG and Marconi.
The sales decrease in 2001 was especially significant at Components (45%), which was partly due to the deconsolidation of Display Components (13%).

Additionally, sales of the businesses Optical Storage and Mobile Display Systems were strongly affected by the decline in the PC and cellular phone markets. Semiconductors' sales decreased 25%, which was caused by the most severe downturn in the semiconductor market ever (30%, according to preliminary WSTS statistics). The economic downturn in the USA had a significant downward effect on sales at Mainstream CE.
Sales growth at Lighting (1%) remained virtually unchanged from the year 2000, while sales at DAP increased (6%), primarily due to the acquisition of Optiva in October 2000. Medical Systems' sales increased by 59%, mainly due to the acquisition of medical systems businesses.

Sales in 2000 grew to EUR 37,862 million, 20% higher than EUR 31,459 million in 1999. The growth was mainly at Semiconductors (55%), Components (22%) and Medical Systems (22%). Various changes in consolidation had, on balance, a neutral effect. Positive effects came from the consolidation of, among others, MiCRUS, MedQuist and Optiva Corporation. Deconsolidations related mainly to Advanced Ceramics & Modules (AC&M) as of July 1, 2000 and Origin as of October 1, 2000.

Income from operations in 2001 amounted to a loss of EUR 1,371 million or 4.2% of sales, compared to profits of EUR 4,281 million, or 11.3% of sales, in 2000 and EUR 1,751 million, or 5.6% of sales, in 1999. Income in 2001 reflected the unprecedented global economic downturn in the telecom and PC-related markets, which heavily impacted the performance of Semiconductors, Components and Consumer Electronics. Overall price erosion increased significantly to 8.2%, compared with 5.3% in 2000. Reduction of the Company's overcapacity and portfolio rationalization resulted in net restructuring and impairment charges of EUR 1,093 million in 2001, while recent acquisitions caused additional amortization of goodwill and in-process R&D write-offs at Medical Systems. Income in 2001 benefited from EUR 430 million negative pension costs (in 2000 EUR 445 million). As a consequence of the weak stock markets, we anticipate significantly lower negative pension costs in income from operations in 2002.

Income from operations in 2000 totaled EUR 4,281 million, or 11.3% of sales, compared to EUR 1,751 million, or 5.6% of sales, in 1999. The largest increase in income from operations was realized by Semiconductors, which more than doubled compared to 1999, reflecting the strong upturn in the market that started in the second half of 1999. Moreover, overall price erosion decreased significantly, while improved efficiency and cost control had a positive impact on income.
All other sectors, except Origin, contributed to the improvement in income from operations in 2000.

Sales and income from operations per sector

	2001		2000		1999	
	sales	income (loss) from operations	sales	income (loss) from operations	sales	income (loss) from operations
Lighting	**5,083**	**623**	5,052	668	4,548	602
Consumer Electronics	**11,052**	**(649)**	13,060	410	11,152	255
DAP	**2,224**	**334**	2,107	287	1,791	220
Components	**2,772**	**(667)**	5,042	608	4,101	293
Semiconductors	**4,389**	**(607)**	5,879	1,346	3,796	614
Medical Systems	**4,834**	**(199)**	3,031	169	2,493	181
Origin	**–**	**–**	717	1,063	1,056	97
Miscellaneous	**1,985**	**(104)**	2,974	(191)	2,522	(118)
Unallocated	**–**	**(102)**	–	(79)	–	(393)
	32,339	**(1,371)**	37,862	4,281	31,459	1,751

The following sectors are reported separately: Lighting, Consumer Electronics, Domestic Appliances and Personal Care, Components, Semiconductors, Medical Systems, Origin (previous years only), Miscellaneous and Unallocated. For a comprehensive business description of the various sectors, please refer to the relevant section in the consolidated financial statements (note 28).
The comments on the business performance per product sector are preceded by a table that includes certain primary performance indicators for the respective years. Sales growth, as mentioned in the performance indicators and comments, consists of the nominal changes in sales (comparison of year-to-year euro amounts). Further sector information is provided in the notes to the consolidated financial statements.

Lighting

amounts in millions of euros	**2001**	2000	1999
Sales	**5,083**	5,052	4,548
% nominal increase	**1**	11	2
Income from operations	**623**	668	602
as a % of sales	**12.3**	13.2	13.2
Income from operations excl. special items	**641**	685	631
as a % of sales	**12.6**	13.6	13.9

The lighting market declined slightly in 2001, hampered by the economic slowdown in the USA and the energy crisis in Brazil, factors not entirely offset by increases in Eastern Europe and Asia Pacific, where markets continued to show positive growth.

Philips' sales growth was 1% positive and totaled EUR 5,083 million in 2001. Excluding Batteries, sales growth was 2%. Sales growth was mainly innovation-driven. Volume growth of 4% was offset by 3% price erosion. Sales growth was particularly strong in Automotive & Special Lighting. Geographically, sales growth was strongest in Asia Pacific. All businesses contributed to a slight improvement in overall market share, reinforcing global market leadership.

Income from operations in 2001 totaled EUR 623 million, or 12.3% of sales. Excluding restructuring charges amounting to EUR 18 million, income was EUR 641 million, or 12.6% of sales. After several years of improved operations and higher margins, income from operations in 2001 was affected by an unfavorable margin mix, due to slower growth of sales of high-end products. In addition, the stronger Polish currency put pressure on margins, as Poland is an important supply base. In the light of these developments, more focused cost management remains key for the profitability of the division. Income in 2001 included a gain on the sale and lease-back of two office buildings (EUR 44 million).

Sales in 2000 increased by 11% to EUR 5,052 million compared to 1999. Currency movements had a positive impact of 9% on nominal sales. Volume growth was 6%, partly offset by increased price erosion of 4%. Overall growth was strong in Asia Pacific, Latin America and Eastern Europe. The strongest sales growth was achieved by the Automotive business, which significantly outperformed the market as a result of successful product innovation.

The improvement in income from operations in 2000 compared to 1999 was mainly the result of the strong sales growth. The largest income improvement was realized by the Lamps business, especially in Europe.

Consumer Electronics

amounts in millions of euros	**2001**	2000	1999
Sales	**11,052**	13,060	11,152
% nominal (decrease) increase	**(15)**	17	(2)
Income (loss) from operations	**(649)**	410	255
as a % of sales	**(5.9)**	3.1	2.3
Income (loss) from operations excl. special items	**(146)**	427	220
as a % of sales	**(1.3)**	3.3	2.0

						2001
amounts in millions of euros	sales		income (loss) from operations			
	amount	% increase	amount	as a % of sales	excluding special items	as a % of sales
Mainstream CE	8,665	(6)	(250)	(2.9)	(186)	(2.1)
Digital Networks	743	(37)	(329)	(44.3)	(207)	(27.9)
Consumer Communications	1,253	(43)	(421)	(33.6)	(104)	(8.3)
Licenses	391	(5)	351	89.8	351	89.8
Consumer Electronics	11,052	(15)	(649)	(5.9)	(146)	(1.3)

Sales in the Consumer Electronics (CE) sector in 2001 totaled EUR 11,052 million, a decrease of 15% compared with the previous year. Sales volume fell by 3%, while average prices decreased by 12%. Price erosion intensified compared with the prior year, due to the weaker demand in most regions and intensified competition. The market decreased by 8% as a result of the global economic slowdown. The US market in particular was hit hard, but a slowdown in growth was also seen in Asia Pacific and Latin America. Sales at Mainstream CE declined by 6% in 2001. Price erosion for the year of 10% was partially offset by a 4% increase in sales volume.

The lower sales of Mainstream CE's products related principally to monitors and VCR. Monitors, particularly OEM sales, were impacted by the downturn in the world PC market. VCR sales, which were affected by the worldwide migration towards DVD, decreased significantly. Although DVD sales nearly doubled, this did not offset the VCR decline. Audio sales decreased 7%, suffering from weak demand in North and Latin America, while sales in Europe and Asia Pacific remained stable. TV sales were marginally lower, balancing lower sales in USA/Canada, Latin America and Asia Pacific with an increase in Europe.

Sales at Digital Networks dropped by 37% compared to last year. The refocus on key customers, combined with a sharply declining market growth rate for set-top boxes (9% in 2001 compared with 73% in 2000), accounted for most of this decrease. Lower sales of satellite and cable network set-top boxes in Europe and lower sales of Internet TV in the USA were only partly offset by doubled sales of satellite/terrestrial set-top boxes in the USA. The worldwide slowdown in the telecom markets contributed to a significant reduction of Broadband Networks sales.

The sharp fall in Consumer Communications sales reflects the scaling-down strategy for GSM mobile phones, which particularly affected sales in Europe. GSM sales continued to show positive growth in Asia Pacific, notably in China.

Income from operations in 2001 decreased to a loss of EUR 649 million, down from a profit of EUR 410 million in 2000. Other than Licenses, which registered higher income due to receipt of royalties on CD-R licenses, all businesses contributed to the significant decline in income. Restucturing charges of EUR 503 million were recorded during the year.

Mainstream CE, in line with the trend in the worldwide CE industry, reported lower margins in most of its markets. Margins were also impacted by actions taken to reduce excess inventories, principally in the USA/Canada. By the end of 2001, inventory levels at Mainstream CE were at a record low. Restructuring charges of EUR 64 million were recorded during the year. These charges related to the closure of the VCR factory in Vienna, Austria, in conjunction with the Company's decision to outsource production and to transfer monitor production from Taiwan to China.

The loss at Consumer Communications originated mainly from the restructuring charges resulting from the refocusing of the mobile handset business. In June 2001 we announced the sale of part of the development and manufacturing activities for GSM to China Electronics Corporation (CEC). In line with the implementation of our restructuring measures, European Telecom plc of the United Kingdom has acquired parts of the unit for industrial operations in the field of mobile telephony in Le Mans, France. Philips will maintain a focused sales and marketing activity in mobile telephony under the Philips brand. Additionally, an agreement has been reached on the sale of the Fax business to SAGEM, which transaction is expected to be closed in the first quarter of 2002 and is subject to the customary approvals. Income in 2001 was positively impacted by a EUR 41 million insurance payment to compensate for business interruption damage caused by a fire in the semiconductor factory in Albuquerque, USA in 2000.

The lower income at Digital Networks reflected the downturn in sales and included special items for the downsizing and write-off of our Internet and Personal TV business in the USA, as well as restructuring charges at Broadband Networks and Digital Transmission Systems and the cost of development of new technologies at MP4Net, Softworks and CryptoTec. Further adjustments to the cost base are ongoing, in line with lower sales growth.

License income increased compared to 2000, primarily due to the recognition of EUR 82 million of CD-R/RW royalties attributable to prior years, mainly resulting from settlements of disputes. During 2001 the basic CD patents expired, except in the USA. Execution of new programs such as CD-R/RW and DVD became more important during 2001.

						2000
amounts in millions of euros	sales		income (loss) from operations			
	amount	% increase	amount	as a % of sales	excluding special items	as a % of sales
Mainstream CE	9,265	12	183	2.0	201	2.2
Digital Networks	1,178	37	(85)	(7.2)	(85)	(7.2)
Consumer Communications	2,207	27	1	–	–	–
Licenses	410	38	311	75.9	311	75.9
Consumer Electronics	13,060	17	410	3.1	427	3.3

Sales in the Consumer Electronics sector in 2000 totaled EUR 13,060 million, an increase of 17% on the year before. Changes in consolidation had a minor negative effect of 1%, while currency movements had a positive effect of 9% on nominal sales. Sales volume increased by 18%, partly offset by an average price decrease of 9%. Sales of Mainstream CE's products increased in Consumer TV (particularly in the upmarket segment), branded monitors and DVD-Video. Digital Networks recorded sharply higher sales due to strong demand for set-top boxes. Geographically, sales increased most strongly in Asia Pacific and Europe, while sales in Latin America rebounded to positive growth.

Income from operations in the Consumer Electronics sector in 2000 increased to EUR 410 million, up from EUR 255 million in 1999. The increase was mainly attributable to the turnaround to a break-even situation at Consumer Communications. License income increased, mainly due to the higher number of licenses in new programs. Income at Mainstream CE benefited from the higher level of sales. At Digital Networks, the positive contribution from certain satellite applications was more than offset by large start-up costs in the cable segment and in new technologies for the delivery of electronic content.

Domestic Appliances and Personal Care

amounts in millions of euros	**2001**	2000	1999
Sales	**2,224**	2,107	1,791
% nominal increase	**6**	18	3
Income from operations	**334**	287	220
as a % of sales	**15.0**	13.6	12.3
Income from operations excl. special items	**338**	300	220
as a % of sales	**15.2**	14.2	12.3

Sales in 2001 reached EUR 2,224 million, an increase of 6% over the previous year. Changes in consolidation, notably the consolidation of Optiva, lifted sales by 6%.Volume growth was 1%, while average prices declined by 1%. The sales growth is mainly attributable to Oral Healthcare. Sales of male shavers increased steeply in China (16% up), reaching 3.5 million units and reinforcing market leadership in that growth market. This, along with a good performance in Europe, compensated for the lower sales in the USA. The increase in Oral Healthcare was attributable to the successful integration of Optiva, allowing Sonicare to reach the No. 1 market position in the USA. The successful launch of the Senseo Crema coffee maker contributed positively.
Geographically, sales increased strongly in China and Europe. In North America, sales of Philips Oral Healthcare grew sharply, which was partly offset by a decline in the other businesses due to sluggish economic conditions along with the effects of the September 11 terrorist attacks. Adverse economic conditions also negatively impacted sales in Latin America, which primarily affected the Food & Beverage business.

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

Sales in 2000 increased 18% over the year before, positively affected by consolidation changes (4%) and exchange rate fluctuations (8%). Volume growth of 8% was partly offset by price erosion of 2%. The sales growth was mainly attributable to sustained strong growth of the Male Shaving & Grooming business. The Food & Beverage and Home Environment Care businesses also achieved strong increases. Geographically, sales increased strongly in Europe and USA/Canada. In addition, sales in Asia Pacific rebounded from the effects of the economic downturn in the prior year.

Income from operations in 2000 increased by approximately 30%, driven by successful product introductions and portfolio rationalizations. The success of Quadra Action contributed to the growth in Male Shaving & Grooming, while Food & Beverage improved its profitability as a consequence of portfolio rationalization and strict cost control.

Components

amounts in millions of euros	**2001**	2000	1999
Sales	**2,772**	5,042	4,101
% nominal (decrease) increase	**(45)**	23	(3)
Segment revenues	**3,705**	6,920	5,947
Income (loss) from operations	**(667)**	608	293
as a % of sales	**(24.1)**	12.1	7.1
as a % of segment revenues	**(18.0)**	8.8	4.9
Income (loss) from operations excl. special items	**(510)**	382	190
as a % of sales	**(18.4)**	7.6	4.6
as a % of segment revenues	**(13.8)**	5.5	3.2

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

The financial data relating to Display Components have been consolidated for the first six months of 2001 only, due to the transfer of Display Components into the joint venture with LG Electronics of Korea effective July 2, 2001. No financial result has been recorded on this transfer, except for the related disentanglement costs.

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

amounts in millions of euros	**2001**	2000	1999
Sales	**2,086**	3,048	2,336
Segment revenues	**2,458**	3,757	3,115
Income (loss) from operations	**(529)**	448	143
as a % of sales	**(25.4)**	14.7	6.1
as a % of segment revenues	**(21.5)**	11.9	4.6

Sales in the Components sector totaled EUR 2,772 million in 2001, a decrease of 45% compared to the previous year. A substantial part of the decrease (13%) was caused by the deconsolidation of the Display Components activities. Sales were negatively impacted by a volume reduction of 19% and price erosion of 10%, as a result of the slowdown in key markets such as personal computers and cellular phones. Price erosion was stronger in 2001, up 4% on the prior year. The mobile displays market decreased by 2% in value during 2001, while our sales declined by 30%. Sales at Mobile Display Systems (MDS) declined significantly due to an excess inventory build-up by customers in 2000, which only started to improve in the third quarter of 2001. Furthermore, market acceptance of color screens was slow, except in Japan, where MDS does not yet have a market position.

The optical storage market witnessed a severe decline of 32% in 2001. Our performance in this business was slightly below the market, mainly due to time-to-market issues. Segment revenues decreased by 46% (28% after adjustment for changes in consolidation and exchange rates).

Income from operations decreased considerably to a loss of EUR 667 million in 2001.The results were impacted by special items comprised of restructuring costs (EUR 156 million), disentanglement costs related to the transfer of Display Components to the joint venture with LG Electronics (EUR 42 million) and a partial release of EUR 41 million of the provision related to the sale of the Advanced Ceramics & Modules (AC&M) activities in 2000.

Restructuring actions have been taken to realign the cost levels of the organizations to the present market situation. In Optical Storage, automotive manufacturing sites have been concentrated in Györ, Hungary. Manufacturing of the CD-ReWritable (CD-RW) drives has been outsourced and is located in the Philippines. The Optical Pick-up Units (OPU) manufacturing has been concentrated in Shanghai, as have most of the Super Twisted Nematic (STN) manufacturing sites of Mobile Display Systems. Excluding the special items, income from operations amounted to a loss of EUR 510 million in 2001. This was mainly due to the decline in Optical Storage and Mobile Display Systems sales as a result of the depressed markets. Capital expenditures have been lowered to minimum levels, while overhead and selling expenses have also been reduced.

Sales in 2000 totaled EUR 5,042 million, a sharp rise (23%) on the year before. Changes in consolidation, particularly the divestment of AC&M as of July 1, 2000, had a negative effect of 5%. Currency movements had a positive effect of 14% on nominal sales. Volume growth was 20%, partially offset by a 6% reduction in average selling prices. Segment revenues were 16% higher than in the previous year. The larger part of the sector's growth was realized in Optical Storage, whose sales were more than 80% higher than the year before. In addition, strong growth was realized by Flat Display Systems, whose components are used in mobile telephones and other mobile applications.

Income from operations benefited from the higher sales in 2000. The divestment of the AC&M business generated a profit of EUR 309 million. All businesses, except for Flat Display Systems, reported major improvements during 2000. Income from operations in 2000 included restructuring charges of EUR 78 million relating to Display Components and Flat Display Systems. Income in 1999 benefited from a gain on the sale of the Conventional Passive Components activities of EUR 169 million, partly offset by restructuring charges of EUR 66 million.

Semiconductors

amounts in millions of euros	**2001**	2000	1999
Sales	**4,389**	5,879	3,796
% nominal (decrease) increase	**(25)**	55	18
Segment revenues	**4,940**	6,812	4,557
Income (loss) from operations	**(607)**	1,346	614
as a % of sales	**(13.8)**	22.9	16.2
as a % of segment revenues	**(12.3)**	19.8	13.5
Income (loss) from operations excl. special items	**(403)**	1,344	660
as a % of sales	**(9.2)**	22.9	17.4
as a % of segment revenues	**(8.2)**	19.7	14.5

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

Sales in the Semiconductors sector in 2001 totaled EUR 4,389 million, down 25% compared to the year 2000, despite the 3% positive effect of the acquisition of MiCRUS as of June 1, 2000. Sales volume decreased by 18%, while average prices declined by 10%. The effect of exchange rate differences was negligible. The significant decline, which occurred in all business lines and geographic regions, was caused by the most severe downturn in semiconductor history (30% according to preliminary WSTS statistics), resulting from the slowdown of the world's economies and the PC and telecom markets. Overall market share increased, as the downturn in the DRAM memories business, in which Philips is not active, was even worse. Lower than expected presence in high-growth markets put pressure on our share of the markets we serve. Exposure to low-growth but profitable markets such as analog is still significant, and focus on high-growth digital markets continues. Segment revenues decreased by 27% in 2001.

Income from operations in 2001 included special items of EUR 204 million, consisting of restructuring charges related to the closure of a wafer fab in Albuquerque, USA, the announced closure of a fab in Caen, France, the reduction of inventory levels and the streamlining of operational costs. Excluding these items, income decreased considerably compared with last year, mainly as a result of the aforementioned sales declines. The severe market conditions, coupled with a worldwide increase in production capacity, led to 40% factory utilization, which is approximately 25% below break-even level. To reduce overcapacity, capital expenditures were lowered as much as possible. To further limit our exposure to capital commitments, cooperation with TSMC, SSMC and ST Micro-electronics will be continued, including a joint 12-inch pilot fab that is being built with STM.

Income in 2001 also included EUR 39 million for the settlement of insurance claims for the Albuquerque fire in 2000.

Sales in 2000 increased by 55% to EUR 5,879 million. The consolidation of MiCRUS from June 1, 2000 had a positive effect of 3% on nominal sales. In addition, 2000 contains the full-year sales of VLSI, compared to 7 months in 1999 (a positive effect of 8%). Furthermore, currency movements had a substantial positive effect of 14% on nominal sales. Volume growth was 33%, while average prices decreased by 3%. All businesses and regions contributed to the large sales increases.

Income from operations in 2000 totaled EUR 1,346 million. The main reason for the improvement in income compared to the previous year was the higher sales level due to the general upturn in the industry, which led to shortages in the market during the year. The acquisition of MiCRUS increased capacity. The VLSI acquisition was successfully integrated into the existing businesses.

Medical Systems

amounts in millions of euros	**2001**	2000	1999
Sales	**4,834**	3,031	2,493
% nominal increase	**59**	22	28
Income (loss) from operations	**(199)**	169	181
as a % of sales	**(4.1)**	5.6	7.3
Income from operations excl. special items	**255**	213	181
as a % of sales	**5.3**	7.0	7.3

During the year 2001 Philips acquired the medical systems divisions of Agilent and Marconi, substantially improving its position in the medical markets, particularly patient monitoring and medical diagnostic imaging.

Sales in the Medical Systems sector in 2001 totaled EUR 4,834 million, representing 59% growth, of which 49% came from acquisitions. The strategy to have a complete product range with a No. 1 or 2 position in the markets in which we operate was accomplished upon the acquisition of the medical systems businesses of Agilent and Marconi. The acquisition of Agilent Healthcare Solutions Group in August 2001 added 20% to sales growth. Marconi Medical Systems was acquired in October 2001 and increased sales by 11%. The acquisitions of MedQuist (July 2000) and ADAC (December 2000) added 7% and 11% respectively to the sales growth in 2001. Volume growth of 12% was partly offset by an average price decrease of 3%. Currency effects were positive 1%. All regions realized positive sales growth, most significantly North America and Europe. In product terms, the main growth areas are magnetic resonance, computed tomography, X-ray and the customer support business. Order intake, excluding acquisitions in 2001, increased by 11%, ahead of the 7% market average. The increase was primarily due to Magnetic Resonance, Imaging IT and Cardio-vascular.

Income from operations in 2001 included acquisition-related costs including in-process R&D write-offs of EUR 379 million and restructuring charges of EUR 75 million. After the recent acquisitions, income from operations for the year 2001 included amortization costs for goodwill and other intangibles for an amount of EUR 231 million, compared to EUR 95 million in 2000. Excluding special items and amortization charges, income from operations improved by EUR 178 million. This significant improvement in operational income is primarily attributable to the increased sales and higher profit margins in the Magnetic Resonance and X-ray businesses where Philips is the market leader. MedQuist also contributed to the improvement. The integration of the new acquisitions and the related restructuring program are on schedule.

Sales in the Medical Systems sector in 2000 totaled EUR 3,031 million, representing growth of 22%. The acquisition of MedQuist as of July 1, 2000 increased sales by 8%. In addition, currency movements had a positive effect of 10% on nominal sales. Volume growth was 7%, while prices decreased on average by 3%. Sales growth was particularly strong in Asia Pacific and North America. In product terms, the main growth areas were magnetic resonance, cardio-vascular, ultrasound and the customer support business.

Income from operations in 2000 amounted to EUR 169 million, compared to EUR 181 million in 1999. The acquisition of ADAC resulted in a fourth-quarter charge of EUR 44 million for the write-off of in-process R&D. Excluding amortization of intangibles related to the acquisitions of MedQuist and ADAC in 2000 and ATL Ultrasound in 1998, income was EUR 308 million, which was a EUR 89 million improvement over 1999.

In addition to the positive contribution of MedQuist, USA/Canada in particular contributed to this improvement, partly due to the strong US dollar. Income from operations of ATL Ultrasound improved over 1999, despite the negative effects of the strong US dollar due to ATL's US-based production facilities. Income performance in Eastern Europe was weak due to a lower sales level.

Origin

amounts in millions of euros	2000	1999
Sales	717	1,056
% nominal (decrease) increase	(32)	0
Segment revenues	1,164	1,735
Income from operations	1,063	97
as a % of sales	.	9.2
as a % of segment revenues	91.3	5.6
Income (loss) from operations excl. special items	(9)	97
as a % of sales	(1.3)	9.2

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

Due to the Atos Origin merger, the financial data relating to Origin were included in the consolidated Philips accounts of 2000 for nine months until October 1. With effect from that date, the Philips share in the results relating to the merged activities of Atos Origin has been included in the results relating to unconsolidated companies on a three-month delayed basis, due to Atos Origin's different reporting cycle.

Income in 2000 included a gain of EUR 1,072 million related to the Atos Origin merger.

Miscellaneous

amounts in millions of euros	**2001**	2000	1999
Sales	**1,985**	2,974	2,522
% nominal (decrease) increase	**(33)**	18	3
Income (loss) from operations	**(104)**	(191)	(118)
as a % of sales	**(5.2)**	(6.4)	(4.7)
Income (loss) from operations excl. special items	**(246)**	(56)	(70)
as a % of sales	**(12.4)**	(1.9)	(2.8)

This sector comprises various activities and businesses not belonging to a product sector. It consists mainly of two groups of activities: the central research and technology centers (such as Philips Research, Intellectual Property and Standards, Philips Centre for Industrial Technology and Philips Design) and Corporate Investments (such as NavTech, Assembléon (formerly EMT) and Philips Enabling Technologies Group (PETG)). NavTech was consolidated in 2001 following the conversion of loans to NavTech into equity, raising our participation from 50% to 82%.

Sales in the Miscellaneous sector in 2001 totaled EUR 1,985 million, a 33% decrease from 2000, mainly due to the deconsolidation of FEI, Philips Broadcast and Marantz.

Income from operations in 2001 benefited from gains on the sale of part of the investment in FEI (EUR 185 million) and of Philips Broadcast to Thomson Multimedia of France (EUR 57 million), partly offset by restructuring charges, mainly for PETG and Assembléon, and acquisition-related costs. Excluding these special items, income in 2001 decreased significantly due to operating losses in particular at PETG and Assembléon, which suffered from the downturn in the semiconductor equipment market. These operating losses were partly offset by the improved performance of Philips Speech Processing. Moreover, starting in May 2001, income of the profitable FEI business was reported, under results related to unconsolidated companies, while the loss-making activities of NavTech, formerly recorded under results of unconsolidated companies, were consolidated and reported in the Miscellaneous sector.

Sales in the Miscellaneous sector in 2000 totaled EUR 2,974 million, representing an 18% increase over 1999. Changes in consolidation had a downward effect of 4%, while the appreciation of currencies had a positive effect of 8%. Sales growth was particularly strong at Assembléon, FEI and PETG. Geographically, Asia Pacific recorded the most significant sales growth.

Income from operations in 2000 amounted to a loss of EUR 191 million, or 6.4% of sales, compared to a loss of EUR 118 million, or 4.7% of sales, in 1999. The income of the Miscellaneous activities was affected by special items including disentanglement costs related to the sale of Philips Projects (EUR 70 million), charges related to the impairment of identified intangibles and goodwill of Voice Control Systems (EUR 35 million) and restructuring charges (EUR 30 million).

A number of businesses in the Corporate Investments group are in the low-growth low-return area and are being considered for divestment.

In 2001, expenditures for Research and Development activities included in income of the product divisions, mainly Semiconductors, amounted to EUR 3,312 million, representing 10.2% of sales, compared to EUR 2,766 million, or 7.3% of sales, in 2000, and EUR 2,284 million, or 7.3% of sales, in 1999. The major increase in 2001 compared to the previous year was caused by the higher level of research and development activities and also included the effect of consolidation changes for an amount of more than EUR 200 million. A major part of these expenditures relates to contract research which is commissioned by the product divisions. Expenditures related to basic Company research are reported in this sector. To become more effective, as well as to adjust to the lower level of short-term contracts, Research recently announced its intention to reduce the worldwide organization by about 10% of the total workforce. Long-term corporate-funded research investments will not be affected.

Unallocated

This product sector comprises the costs of the corporate center – including the Company's initial funding of e-business and global brand management programs – as well as country and regional overhead costs. Income from operations amounted to a loss of EUR 102 million in 2001, compared to losses of EUR 79 million and EUR 393 million in 2000 and 1999 respectively.
A decline in group overheads in 2001 was offset by lower pension credits.

Sales and income from operations by geographic area

	2001		2000		1999	
	sales	income (loss) from operations	sales	income from operations	sales	income (loss) from operations
Europe	**13,920**	**(479)**	16,967	3,246	14,658	1,124
USA/Canada	**9,296**	**(854)**	9,565	186	7,918	82
Latin America	**1,918**	**(13)**	2,285	59	1,862	(41)
Africa	**237**	**(10)**	271	3	229	1
Asia Pacific	**6,968**	**(15)**	8,774	787	6,792	585
	32,339	**(1,371)**	37,862	4,281	31,459	1,751

All regions recorded lower sales in 2001, particularly Europe, Asia Pacific and Latin America.
Sales in USA/Canada were 3% below the level in 2000, despite the 11% increase resulting from the acquisitions at Medical Systems. Excluding Medical Systems, sales in USA/Canada decreased significantly, particularly at Consumer Electronics, Components and Semiconductors, which were impacted by the downturn in the US economy and weak demand in the PC and telecommunications markets.
Sales in Europe were 18% lower than in 2000, part of which (5%) was caused by deconsolidation effects. The primary reason for the decrease was the reduced sales at Consumer Communications. Additionally, the decision to refocus on a limited number of platforms resulted in significant decreases at Digital Networks. Other steep declines were posted at Components and Semiconductors. Sales of Mainstream CE remained unchanged in spite of weaker markets.
Sales in Asia Pacific were 21% lower than in 2000, of which 5% is attributable to the deconsolidation of Display Components. Other important decreases related to Mainstream CE, Digital Networks, Licenses, Components and Semiconductors. On the upside, increases were recorded at Lighting, Consumer Communications and Medical Systems.

Sales in Latin America were 16% lower than in 2000, affected by consolidation changes, which had a negative effect of 6%, and weaker currencies (5%). DAP, Digital Networks, Components and Semiconductors generated significantly lower sales. On the positive side, sales at Medical Systems increased strongly.

Sales growth in 2000 was strong in all regions, particularly Asia Pacific. Sales in Asia Pacific increased strongly and ended 29% above the 1999 level, with all sectors contributing, especially Semiconductors. The sharp upturn of sales in Europe (16%) was driven by Semiconductors, Components and Consumer Electronics. In addition, Latin America recorded substantial positive growth, recovering from the weak sales in the years before. The recovery was led by Brazil, benefiting from the upturn in economic conditions in that country. In 2000, USA/Canada recorded a 21% increase in sales compared to 1999, attributable to the strong rise of the US dollar and the new acquisitions in the region.

Income from operations in 2001 deteriorated in all regions. Europe, Asia Pacific and USA/Canada incurred the sharpest decreases in income, driven by the unfavorable developments at Semiconductors, Components and Consumer Electronics.
In 2000, income in Europe and Asia Pacific was positively affected by the non-cash gain from the Atos Origin merger and the gain on the sale of the AC&M business.

Cooperative business activities and unconsolidated companies

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

Taiwan Semiconductor Manufacturing Company Limited (TSMC) is a semiconductor foundry operation in which Philips currently holds 21.8% of the total number of outstanding common shares. Additionally, the Company has purchased redeemable preferred shares, bringing its total holding in TSMC to approximately 27.5%. The principal reasons for this shareholding are to secure a strategic supply of wafers, to share and exchange technology and manufacturing knowledge, and to reduce capital expenditures.

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

Atos Origin started on October 1, 2000, when Origin was merged with Atos of France. The merger has created a leader in end-to-end business and e-business solutions. The company is operational in 30 countries. Philips holds a 48.7% stake in Atos Origin. In 2002, Philips may reduce its stake in the combined entity to below 35%, subject to market conditions being acceptable. Philips has also received two tranches of stock warrants, each representing approximately 2.4 million Atos Origin shares, which may be exercised only on certain conditions, subject to the appreciation of the Atos Origin share price to specified levels.

LG.Philips LCD Co. is a 50/50 manufacturing joint venture with LG Electronics of South Korea, and is the world's second-largest supplier of active-matrix liquid crystal displays. This joint venture has enabled Philips to become a leading company in the area of active-matrix LCDs, a display technology that is rapidly migrating from notebook displays to desktop monitors, and in the near future to other areas, including television. As a consequence, the Company believes this business has the potential for rapid growth.

LG.Philips Displays is a 50/50 joint venture with LG Electronics of South Korea, which was established effective July 2, 2001, and is a leading supplier in its line of business. The joint venture combines the two companies' complementary strengths and creates a strong synergy potential in the mature CRT display market.

In the LumiLeds Lighting 50/50 joint venture, Philips and Agilent have the complementary strengths and positions to successfully develop the market for LED-based lighting products. Both companies have expanded the scope of their existing activities. Both parties hold equal shares in the venture, whose product portfolio has been extended from LED traffic signal products to a variety of other applications, including automotive, signaling, contour lighting and signs, illumination and LCD backlighting, demonstrating both parties' confidence in the new technology. At year-end 2001, the operations were located in the USA, Malaysia and the Netherlands.

FEI Company is a US-based company in which Philips previously held the majority of the shares. On May 22, 2001, Philips sold a significant portion of these shares, retaining 25.5% of the outstanding shares. FEI is the leading supplier of Structural Process Management ™ solutions to the world's technology leaders in the fields of semiconductors, data storage and biological structures.

By year-end 2001 the Corporate Venturing portfolio comprised some 30 companies in which Philips has both a minority stake and a business relationship. During 2001, the Company made a small number of new investments, while disposing of certain investments from prior years.

Results relating to unconsolidated companies

Results relating to unconsolidated companies amounted to a loss of EUR 754 million in 2001, compared to profits of EUR 3,970 million in 2000 and EUR 409 million in 1999. The composition of these results is as follows:

	2001	2000	1999
Income (loss) excl. amortization of goodwill and other intangibles and special items	**(139)**	697	391
Amortization of goodwill and other intangibles	**(367)**	(124)	(49)
Special items:			
- Restructuring and impairment charges	**(208)**		
- Gain on sale of shares	**20**	2,717	
- Dilution (losses) gains TSMC	**(60)**	680	67
	(754)	3,970	409

The unfavorable results in 2001 compared to 2000 are primarily attributable to a deterioration in the performance of virtually all of our major unconsolidated companies, coupled with increased amortization of goodwill and other intangibles and the effect of special items.

The performance of Taiwan Semiconductor Manufacturing Company (TSMC), LG.Philips LCD and the newly established joint venture LG.Philips Displays was affected by overcapacity and the severely depressed telecom and PC-related markets, resulting in sharp price erosion and low sales volumes. Results in 2001 also reflect full-year goodwill amortization of Atos Origin and half-year amortization of LG.Philips Displays.
Excluding special items and amortization of goodwill and other intangibles, Philips' share in the 2001 results of TSMC and the two joint ventures with LG Electronics of Korea amounted to a profit of EUR 144 million and a loss of EUR 205 million respectively (in 2000 a profit of EUR 518 million and a profit of EUR 286 million respectively).
The 2001 results were affected by several special items. The employee bonus stock option program of TSMC had the effect of diluting Philips' shareholding in the company, resulting in a loss of EUR 60 million. Additionally, the results of TSMC included a charge for impairment of EUR 82 million. Restructuring charges at LG.Philips Displays of EUR 89 million, and the write-down of certain Corporate Venturing investments totaling EUR 37 million also impacted earnings.This year's income was positively affected by a gain of EUR 20 million resulting from the sale of the Company's stake in Philips Matsushita Battery Corporation.

In 2000, LG.Philips LCD contributed to income for the full year, compared with only six months in 1999. The share in income of ASML, in which Philips' stake was reduced in 2000, was significantly higher during the first five months of 2000 than in the previous full year, reflecting ASML's profitable situation. These income improvements were partly offset by our share in the losses of Systems on Silicon Manufacturing Company (SSMC) due to the high costs of ramping-up the factory, start-up expenses at LumiLeds and increased funding requirements of NavTech. In 2001, the latter was consolidated due to the increase in our shareholding to 82% through the conversion of Philips loans to NavTech into equity. TSMC's result in 2000 benefited from the favorable semiconductor market.
Income in 2000 was favorably impacted by a number of special items. A substantial portion of the ASML shares was sold, resulting in a gain of EUR 2,595 million, while Philips' 33% interest in Beltone Electronics was exchanged for GN Great Nordic shares, resulting in a transaction gain of EUR 122 million. In 2000 several equity transactions by TSMC resulted in a net dilution gain of EUR 680 million.

Income in 1999 was positively influenced by the significant contribution from LG.Philips LCD and improving TSMC results, which reflected TSMC's capacity increase and the upturn in the semiconductor industry in that year. ASML reported a 31% increase in earnings, reflecting a particularly strong second half of the year.

Restructuring and impairment charges

The weak economic conditions around the world, together with unacceptably low profitability in certain business areas, required strong measures from management. In 2001 we reduced overcapacity, aligned our cost base to the prevailing market situation, and addressed a number of loss-making activities. This, combined with the ongoing process of efficiency improvement and portfolio rationalization, has led to restructuring and impairment charges, for various projects, of EUR 1,093 million, net of releases.
The most significant projects in 2001 were:

- the outsourcing of mobile phone development and manufacturing (EUR 318 million);
- the closure of production lines at Semiconductors, Albuquerque, USA, and Caen, France (EUR 204 million);
- rationalization of manufacturing capacity at Optical Storage and process rationalization at Mobile Display Systems, Components (EUR 167 million);
- programs to reduce platform diversity at Digital Networks (EUR 122 million);
- integration and process standardization of the European commercial sector of Medical Systems after the acquisition of the medical systems businesses of Agilent and Marconi (EUR 74 million);
- downsizing of Philips Enabling Technologies Group in the Netherlands and Belgium and the worldwide Assembléon activities (EUR 67 million);
- outsourcing of video recording development and manufacturing activities in Austria (EUR 44 million).

Restructuring charges in 2000 amounted to EUR 162 million, consisting of EUR 208 million for new projects at Consumer Electronics, Components, Lighting and Miscellaneous, partly offset by releases of EUR 46 million. Individually, the largest projects in 2000 were the closure of the large-screen operations of Hosiden and Philips Display (HAPD) in Kobe, Japan, and the streamlining of the Display Components activities in Germany and Taiwan.

In 1999, overall net restructuring charges totaled EUR 86 million, consisting of EUR 164 million for various projects in the Lighting, Components, Consumer Electronics and Miscellaneous sectors, partly offset by releases of EUR 78 million. Individually, these projects were not of material significance, the largest being the restructuring of the Flat Panel Display activities at Waalre in the Netherlands (EUR 38 million).

Total gross restructuring charges in 2001, 2000 and 1999 can be categorized as follows:

	2001	2000	1999
- Personnel lay-off costs	**437**	125	71
- Write-down of assets	**547**	57	81
- Other costs	**136**	26	12
	1,120	208	164

In 2001 releases of surplus restructuring provisions totaled EUR 27 million. The releases were primarily related to Lighting and Components and were caused by reduced severance requirements, due to the transfer of employees scheduled to be laid-off to other positions within the Company.
In 2000 surplus provisions amounted to EUR 46 million, due to lower expenditures on completed projects, and were related to Consumer Electronics, Lighting, Components, Semiconductors and Miscellaneous, while in 1999 lower expenditures led to releases of EUR 78 million, primarily for Lighting, Consumer Electronics and Components.

Restructuring projects started in 2001 have led to a headcount reduction of approximately 10,800, of which 7,000 relate to direct labor and 3,800 to indirect labor (total lay-offs in 2000 approximately 5,000 persons, and in 1999 approximately 1,500 persons). There are more lay-offs expected in 2002 to complete the restructuring projects initiated during 2001.
Asset write-downs in 2001 are primarily related to Digital Networks and Consumer Communications (as part of Consumer Electronics), Components and Semiconductors. In 2000, asset write-downs were recorded primarily in the Components and Miscellaneous sectors, while in 1999 they largely related to Components and Lighting. Other charges mainly reflect the costs involved in the cancellation of various suppliers' contracts.

In general, restructuring plans lead to cash outflows in the year in which they are recognized or in the following year, and are financed from the normal cash flow from operations. Estimated cash outflows relating to projects started in 2001 and previous years can be summarized in the following table:

	total					of which
	charges	non-cash	cash 1999	cash 2000	cash 2001	cash 2002
Restructuring 2001	1,120	554			124	442
Restructuring 2000	208	60		106	42	
Restructuring 1999	164	83	39	42		

Future cash outflows are based on estimates.

Philips' share in restructuring charges recognized by unconsolidated companies amounted to EUR 89 million and as such is included in the results relating to unconsolidated companies.

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

Financial income and expenses

Financial income and expenses amounted to a net expense of EUR 915 million in 2001, compared to income of EUR 1,988 million in 2000 and EUR 32 million in 1999. Net interest expenses amounted to EUR 391 million in 2001, compared with EUR 167 million in 2000 and EUR 129 million in 1999. The net interest expenses in 2001 and 2000 were higher, mainly as a result of the higher net debt level of the Group, partly offset by lower interest rates.

Unlike previous years, financial income in 2001 did not include gains from the sale of marketable securities. During the year 2000 the Company sold a portion of the JDS Uniphase shares that had been received upon the sale of Philips Optoelectronics. The gain from the sale amounted to EUR 1,207 million. Moreover, in 2000, Seagram shares were exchanged for shares of Vivendi Universal. The shares in Seagram had previously been obtained as a partial settlement of the sale of Philips' 75% stake in PolyGram in 1998. The 2000 gain from the exchange of Seagram shares amounted to EUR 966 million. In 1999 a gain of EUR 117 million was realized on the sale of a portion of the JDS Uniphase shares.

In view of the extended period of time over which the market value of our security investments in Vivendi Universal and GN Great Nordic was below bookvalue, these shares were written down to fair value at December 31, 2001, being EUR 2,353 million and EUR 46 million respectively. The impairment losses of EUR 440 million and EUR 86 million respectively are included in financial income and expenses.

In addition, in 2001, dividends totaling EUR 33 million were received on the Vivendi Universal shares, while in 2000 dividends totaling EUR 32 million were received on the Seagram shares, compared with EUR 28 million in 1999.
Hedging costs and costs to swap borrowings to the applicable currency and interest profile amounted to EUR 64 million in 2001 and EUR 86 million in 2000. In 1999 these costs amounted to EUR 7 million.

Income tax

The income tax benefit totaled EUR 421 million in 2001, compared to charges of EUR 570 million in 2000 and EUR 336 million in 1999. This corresponds to an effective tax rate of 18%, up from 9% in 2000 but down from 19% in 1999. For the coming year the Company expects an effective tax rate of around 25%. The effective tax rate for 2001 was affected by non-deductible charges for the impairment of securities (tax effect 6%), whereas the effective tax rate for 2000 was influenced by tax-exempt proceeds from the sale of various securities (tax effect 13%).

Minority interests

In 2001, the share of third-party minority interests in the loss of group companies amounted to EUR 15 million, compared with the share in income of EUR 67 million and EUR 52 million in 2000 and 1999 respectively.
This change is primarily attributable to the consolidation of NavTech as of January 1, 2001 and the deconsolidation of FEI in May 2001. Moreover, minority interests decreased as a consequence of the buy-out of minority shareholdings in India, Pakistan and South Africa.

In 2000 the increase was fully attributable to the improved results of FEI Company and the China operations, partly offset by losses of HAPD absorbed by third-party shareholders.

Net income

Income from continuing operations amounted to a loss of EUR 2,604 million in 2001 (EUR 2.04 per common share – basic) compared to income of EUR 9,602 million (EUR 7.31 per common share – basic) in 2000 and EUR 1,804 million (EUR 1.31 per common share – basic) in 1999.

There were no extraordinary items in 2001 and 2000, whereas a loss of EUR 5 million was recorded in 1999. The extraordinary loss in 1999 related entirely to premiums paid for the early redemption of long-term debentures.

Net income in 2001 amounted to a loss of EUR 2,604 million (EUR 2.04 per common share – basic) compared to income of EUR 9,602 million (EUR 7.31 per common share – basic) in 2000 and EUR 1,799 million (EUR 1.31 per common share – basic) in 1999.

US GAAP

The Group financial statements have been prepared on a basis consistent with Dutch GAAP, which differs in certain respects from US GAAP. Income from continuing operations determined in accordance with US GAAP amounted to a loss of EUR 2,475 million in 2001, compared with a profit of EUR 9,577 million in 2000 and a profit of EUR 1,595 million in 1999. These aggregate amounts result in basic earnings per common share of a loss of EUR 1.94 in 2001, a profit of EUR 7.30 in 2000 and a profit of EUR 1.16 in 1999. Diluted earnings per common share amounted to a loss of EUR 1.94 in 2001, a profit of EUR 7.22 in 2000 and a profit of EUR 1.15 in 1999.

Please refer to note 27 to the consolidated financial statements for a description of the primary differences between Dutch GAAP and US GAAP and the US GAAP earnings per common share.

Cash flows

Cash flows from operating activities in 2001 amounted to EUR 1,248 million, substantially lower than in previous years, mainly due to the lower profitability of the Company. In 2000 a positive cash flow of EUR 2,996 million was reported, compared to EUR 1,913 million in 1999. A substantial reduction of inventories, partly caused by supply chain improvement programs, and lower receivables were partly offset by lower payables and contributed a net cash flow of EUR 1,080 million. In 2000 the working capital requirements amounted to EUR 1,069 million and in 1999 to EUR 469 million.

Expressed as a percentage of sales, inventories were 13.3% of sales at the end of 2001, compared to 13.9% at the end of 2000 and 14.5% at the end of 1999. Outstanding trade receivables at year-end 2001 were the equivalent of 1.5 months' sales, compared to 1.5 months' at the end of 2000 and 1.4 months' a year earlier.

Cash flows from investing activities required EUR 4,564 million in 2001, EUR 2,404 million in 2000 and EUR 3,834 million in 1999.
During the year 2001, Philips invested EUR 3,636 million in businesses operating in strategic areas to further strengthen its global market position. The investments included the purchase of the assets of the Healthcare Solutions Group of Agilent (EUR 1,943 million) and the acquisition of the medical systems activities of Marconi for EUR 1,245 million. In 2001, LG Electronics redeemed its 7.5% redeemable preferred shares. This redemption resulted in a cash inflow of EUR 486 million. In addition, EUR 200 million was generated by the sale of a portion of the shares in FEI and the repayment by FEI of loans from Philips. Furthermore, EUR 295 million was generated by the sale of the Glass business to LG.Philips Displays.

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

During 1999, the Company's investment in businesses amounted to EUR 2,993 million. These investments included the purchase of VLSI Technology of the USA (EUR 976 million) and of a 50% share in LG.Philips LCD of Korea (EUR 1,496 million), as well as the acquisition of an additional 10% of the shares in Origin (EUR 124 million) and of a number of smaller businesses (EUR 397 million). The largest divestment, that of Philips' Conventional Passive Components business, yielded a net amount of EUR 323 million in cash. Additionally, the sale of a minority interest in NavTech generated a positive cash flow of EUR 98 million. Furthermore, EUR 158 million was generated by the sale of a portion of the JDS Uniphase shares.

In 2001 cash requirements for capital expenditures were scaled back substantially as the Company aligned its manufacturing facilities more closely to the market (especially at Components and Semiconductors). Gross capital spending on property, plant and equipment of EUR 2,143 million in 2001 compared with EUR 3,170 million in 2000. In 1999 an amount of EUR 1,662 million was spent. In 2001 the ratio of gross investments to depreciation was 1.1, compared to 1.8 in 2000 and 1.1 in 1999.

As a result of the items mentioned above, cash flows before financing activities were negative EUR 3,316 million, compared with positive EUR 592 million in 2000 and negative EUR 1,921 million in 1999.

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

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

In 1999 the net cash flows used for financing activities came to EUR 2,606 million, of which EUR 1,490 million was used for an 8% share reduction program. Additionally, EUR 717 million was used to repay interest-bearing debt and EUR 361 million was used for the payment of dividends to Philips shareholders. An amount of EUR 38 million net cash was used for treasury stock transactions.

Financing

Total debt outstanding at the end of 2001 was EUR 7,866 million, compared with EUR 4,027 million at the end of 2000 and EUR 3,314 million at the end of 1999.

In 2001, long-term debt increased by EUR 4,311 million to EUR 6,595 million. This increase is the net result of new borrowings of EUR 4,580 million, repayments totaling EUR 554 million, the decrease of the current portion of long-term debt by EUR 293 million and currency, (de)consolidation and other effects of EUR 8 million. During 2001, Philips issued four new bonds for a total amount of EUR 4,250 million in two tranches. Two outstanding bonds matured during 2001 for a total amount of EUR 441 million. In 2000, long-term debt was reduced by EUR 453 million to EUR 2,284 million. The reduction was the result of net repayments totaling EUR 122 million and the reclassification of long-term debt into short-term debt for an amount of EUR 377 million, offset by currency, (de)consolidation and other effects of EUR 46 million.

Philips had two 'putable' USD bonds outstanding at year-end 2001 for a total amount of EUR 304 million. The investors may require repayment in one specific month during the lifetime of the respective bonds. Assuming that investors require repayment at the relevant put dates, the average remaining tenor of the total outstanding long-term debt was 5.2 years, compared to 5.9 years in 2000. However, assuming that the 'putable' bonds will be repaid at maturity, the average remaining tenor at the end of 2001 was 6.1 years, compared to 8.4 years at the end of 2000. Long-term debt as a proportion of the total debt at the end of 2001 stood at 84%, compared to 57% at the end of 2000.

At the end of 2001, the Group had long-term committed and undrawn credit lines available of USD 2,500 million, unchanged from a year earlier. The USD 2,500 million committed credit line is a multi-currency revolving standby credit facility, which was signed in July 1996 and will expire in July 2003.

Short-term debt decreased by EUR 472 million in 2001 to EUR 1,271 million at year-end. This decrease was the result of net repayments of EUR 73 million, the decrease of the current portion of long-term debt by an amount of EUR 293 million, and a decrease of EUR 106 million as a result of currency and (de)consolidation effects. At the beginning of 2001, Philips established a global commercial paper program totaling USD 2,500 million. Under this program the outstanding amounts reached a maximum of EUR 1,596 million during the year, while at year-end EUR 521 million was outstanding. The previously mentioned standby credit facility acts as a back-up for the outstanding amount under the global commercial paper program.

Cash and cash equivalents declined by EUR 199 million in 2001 to EUR 890 million at year-end. The currency impacts and (de)consolidation changes accounted for a EUR 42 million decrease. The EUR 1,242 million decrease in cash in 2000 was to a large extent related to the investments in MedQuist, Optiva, ADAC, SSMC and redeemable preferred stock in LG Electronics and TSMC, as well as a 3% share reduction program.

The Company had a net debt position (debt, net of cash and cash equivalents) of EUR 6,976 million at the end of 2001. The net debt position at the end of 2000 amounted to EUR 2,938 million and at the end of 1999 to EUR 983 million. The net debt to group equity ratio amounted to 27:73 at the end of 2001, compared to 12:88 at the end of 2000 and 6:94 at the end of 1999.
Stockholders' equity decreased by EUR 3,283 million to EUR 18,453 million at year-end 2001, which was mainly due to the net loss of EUR 2,604 million in 2001. Translation differences in equity resulted in an increase of EUR 102 million, while the deferred results of financial derivative transactions within equity increased equity by EUR 22 million. Furthermore, equity was reduced by treasury stock transactions of EUR 336 million and by dividend payments of EUR 458 million related to the profit distribution for the year 2000. The EUR 6,979 million increase in equity in 2000 was mainly due to 2000 net income of EUR 9,602 million, partly offset by a 3% share reduction program (EUR 1,673 million).

The number of outstanding common shares of Royal Philips Electronics at December 31, 2001 was 1,274 million (2000: 1,284 million shares).

At the end of 2001 the Group held 41.9 million shares in treasury to cover the future delivery of shares in conjunction with the 50.1 million conversion and stock option rights outstanding at the end of 2001. At year-end 2000, 32.2 million shares were held in treasury against a 33.6 million rights overhang. As the Company cannot predict whether or not performance-related stock options will vest in the future, it has been the Company's policy to hedge all regular option grants and only 50% of the performance-related option grants.

Distribution to shareholders

With the approval of the Supervisory Board and the Meeting of Priority Shareholders, a proposal will be submitted to the General Meeting of Shareholders to make a distribution to shareholders of EUR 0.36. per common share charged to the other reserves (compared with the EUR 0.36 dividend per common share paid in 2001, reflecting the 2000 profit distribution). The balance sheet presented in this report, as part of the consolidated financial statements for the period ended December 31, 2001, is before distribution, which is subject to shareholder approval after year-end. Adoption of the proposal by the General Meeting of Shareholders will result in a total cash payment in the year 2002 and a reduction of the other reserves by approximately EUR 459 million (compared with EUR 458 million in 2001).

Employment

The number of employees at December 31, 2001 totaled 188,643, which is 30,786 lower than at December 31, 2000. A large part of the reduction is related to the deconsolidation of various activities, involving a reduction of 27,684 in total, of which Display Components was the most significant (23,251). Conversely, 15,470 employees were added to the Company's payroll as a result of new acquisitions, the most significant of which were Agilent HSG (4,770) and Marconi (5,200). Excluding the changes related to the portfolio, the number of employees decreased by 18,567. The main reductions in the headcount were at Components (5,207), Semiconductors (4,053), Mainstream CE (2,389) and Consumer Communications (2,165). In geographic terms, Asia Pacific and Europe accounted for most of the decrease.

Employment
(In thousands)

	2001	2000	1999
Nominal position, at year-end	**188.6**	219.4	226.9
Consolidation changes:			
- new consolidations	**15.5**	10.0	3.0
- deconsolidations	**(27.7)**	(20.7)	(5.7)
Comparable changes	**(18.6)**	3.2	(4.1)

Other issues

New accounting standards and possible change in accounting principles

New accounting standards becoming effective in 2002 and a possible change in accounting principles are described in detail on pages 44 and 45.

Risk management

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

Risk management approach

Risk management forms an integral part of business management. The Company's risk and control policy is designed to provide reasonable assurance that strategic objectives are met by creating focus, by integrating management control over the Company's operations, by ensuring compliance with legal requirements and by safeguarding the reliability of the financial reporting. It makes management responsible for identifying the critical business risks and the implementation of fit-for-purpose risk responses. Structured self-assessments are used company-wide to identify and assess business risks and to monitor the effectiveness of compensating controls. In addition, internal and external auditors review the quality of the control system and adherence to the Company's risk and control policy. Accountability is enforced through the formal issuance of a Statement on Business Controls by each business unit, resulting, via a cascade process, in a statement by each product division.

Internal Audit Committees at product division and business level meet on a quarterly basis to address weaknesses in the business control infrastructure as reported by the internal and external auditors and to take corrective action where necessary. They are also involved in determining the desired audit coverage.
Once every quarter, the quality of the Company's system of internal controls and the results of internal and external audits are reported to and discussed in the Audit Committee of the Supervisory Board.

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

Market risks

Philips is active in more than 60 different businesses with different risk profiles, which are geared to the business environment in which they operate and the competitive advantage they aim to achieve.
Depending on the nature of the activity, the risk profile of Philips' businesses is diverse. Some, like Lighting and Domestic Appliances and Personal Care, are active in more stable markets.
Others, like Semiconductors, operate in highly cyclical markets and may experience substantial period-to-period fluctuations in their results as a result of changes in industry conditions, economic conditions or other factors. After last year's record performance, Semiconductors suffered from the steep downturn in the economy in 2001, characterized by diminished product demand, accelerated price erosion and overcapacity in production.

The consumer electronics businesses in which Philips is engaged, including broadband networks and electronic components, are intensely competitive. Accordingly, Philips continually faces challenges from its competitors, including rapid technological change, evolving standards, short product life cycles and price erosion.
In particular, during periods of depressed demand, consumers tend to be more price-sensitive. Such price-driven competition results in a reduction of profit margins in the industry, thus adversely affecting Philips' results.
Philips operates in high-tech markets, and it is Philips' objective to be a high-growth technology company. This objective exposes Philips to the risk of keeping pace with rapid technological development and requires the Company to make large financial investments. Philips continues to utilize partnerships to share these risks. These partnerships take place through minority shareholdings, joint ventures and majority shareholdings. Managing this growing number of strategic alliances (particularly in the form of joint ventures), i.e. bridging the international, legal and cultural differences, is a growing risk in itself. The possible benefits available through such joint ventures may be more difficult to achieve or may prove less valuable than expected. In addition, Philips may face problems related to conflicts of interests, loss of control over cash flows and loss of proprietary technologies by participating in joint ventures.
In its Medical Systems business, Philips made a number of major acquisitions in 2000 and 2001. Currently, the Company is in the process of integrating four newly acquired businesses into its Medical Systems division. This integration process and the alignment of business processes, systems and procedures to create synergies require substantial management attention. A special task force manages this operation.

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

A critical risk area that has our priority attention is human resources. A high-growth technology company requires talented people at all levels of the organization. Employee retention, both of highly specialized technical personnel and of employees in e.g. sales and marketing, research and development, finance and general management, is critical for the success of the Company.

Being a global company, Philips has established subsidiaries in about 70 countries. These subsidiaries are exposed to changes in governmental regulations and unfavorable political developments, which may limit the realization of business opportunities or impair the value of the local Philips investment.

Financial risks

Currency fluctuations may impact Philips' financial results. Furthermore, Philips is exposed to interest rate risk, commodity price risk, equity price risk and credit risk. The Company does not purchase or hold derivative financial instruments for trading purposes.

Currency risk

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

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

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

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

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

Philips does not currently hedge the foreign exchange exposure arising from securities available for sale. Forward foreign exchange hedges that were outstanding at the end of 2000 became ineffective, and the results have been charged to financial income and expenses for an amount of EUR 35 million.

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

An instantaneous 10% strengthening or weakening of non-euro currencies against the euro from their levels at December 31, 2001, with all other variables held constant, would result in an estimated change in the fair value of the Company's financial instruments of EUR 43 million, compared with EUR 18 million in 2000. For the purpose of this analysis, financial instruments consist of debt, liquid assets, securities and derivative financial instruments, leading to the following sensitivity:

	Sensitivity to a 10% increase in the euro versus non-euro currencies
Debt	(589)
Liquid assets	(2)
Securities	(10)
Derivatives	644
Total	43

The US dollar and the pound sterling account for a significant percentage of the above exposure. An instantaneous 10% increase of the US dollar against the euro from their levels at December 31, 2001, with all other variables held constant, and an instantaneous 10% increase of the pound sterling against the euro from their levels at December 31, 2001, with all other variables held constant, would result in the following changes in the fair value of the Company's financial derivatives.

	Sensitivity to a 10% increase in the euro versus the US dollar	Sensitivity to a 10% increase in the euro versus the pound sterling
Derivatives related to debt/liquid assets	558	4
Derivatives related to securities	–	–
Derivatives related to transactions	15	40
Total	573	44

The hedges of forecasted sales and purchases account for a part of the sensitivity calculated above. They are concluded to offset the effect of changes in foreign currency related to forecasted transactions by the businesses. These forecasted transactions are not financial instruments and therefore are not recorded in the accounts of the Company. The hedges related to these forecasted transactions are recorded as cash flow hedges. The results from such hedges currently deferred in equity amount to a loss of EUR 9 million. This loss will be released to the income statement in 2002 when the related hedged transactions affect the income statement.

Virtually all transaction hedges that were outstanding at December 31, 2001 were forward foreign exchange contracts that will expire in 2002. During 2001 no results were recorded in the income statement as a result of ineffectiveness of these hedges.

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

Interest rate risk

At year-end 2001, Philips had a ratio of fixed-rate debt to total outstanding debt of approximately 69%, compared to 48% one year earlier. The Company partially hedges the interest rate risk inherent in the external debt. As of year-end 2001, the Company hedged a notional amount of USD 146 million, compared to current outstanding USD-denominated fixed-rate public debt of USD 1,063 million, EUR 700 million compared to outstanding EUR-denominated fixed-rate public debt of EUR 4,948 million and TWD 12,999 million compared to an investment of TWD 12,999 million.

The Company also entered into five interest rate swaps, paying fixed interest on EUR 110 million and receiving fixed interest on EUR 64 million for general asset and liability management purposes. Interest rate swaps hedge the Company against adverse movements of long-term interest rates. These interest rate hedges related to bonds or investments are fair value hedges; thus profits resulting from the hedges (EUR 41 million in 2001) are offset by equal and opposite losses recorded on the underlying financial instruments in the income statement. At inception of an interest rate swap, the Company requires the correlation between the hedged item and the interest rate swap to match. At December 31, 2001 the condition of correlation continued to exist, therefore there was no hedge ineffectiveness during the year on interest rate swaps. Some interest rate hedges related to bonds were unwound during 2001. The gains on these hedges will be released over the remaining life of the underlying financial instruments to the income statement. In 2002 we expect to release a gain of EUR 5 million. As the fixed flows of the swaps match exactly the coupons of the underlying financial instruments, the hedges are deemed to be effective. No results were released to the income statement as a result of ineffectiveness of interest rate hedges in 2001. The results on other interest rate swaps are recognized in the income statement.

As of December 31, 2001 the majority of debt consisted of bonds. Of the EUR 6,152 million of outstanding bonds, 4.9% have a so-called 'embedded put' feature, which allows the investor to ask for redemption of the bonds in one specific month prior to their final maturity date.

A sensitivity analysis shows that if long-term interest rates were to decrease instantaneously by 1% from their level of December 31, 2001, with all other variables (including foreign exchange rates) held constant, the fair value of the long-term debt and investments would increase by EUR 282 million. In this case, the fair value of debt and investments plus the fair value of related interest rate swaps would increase by EUR 267 million (compared to EUR 106 million in 2000). This increase is based on the assumption that the 'putable' bonds will be repaid at their final maturity date. If the bondholders required payment at their respective put dates and there was an increase in interest rates by 1%, this would reduce the market value of the bonds and investments by EUR 235 million. In this case, the fair value of debt and investments plus the fair value related to interest rate swaps would decrease by EUR 221 million (compared to EUR 71 million in 2000).

Other financial risks
Other financial risks include the equity price risk, the commodity price risk and the credit risk.

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

In 2001, an impairment loss of EUR 526 million was recognized on the security investments in Vivendi Universal and GN Great Nordic in view of the extended period of time during which the market value of these shares was below cost.
In addition to TSMC, Vivendi and Great Nordic, Philips is a shareholder of other publicly listed companies such as Atos Origin, ASML, FEI, JDS Uniphase and MedQuist and therefore is exposed to the equity price risk through movements in the share prices of these companies. The aggregate market value of all these investments exceeded the book value by EUR 8,838 million at year-end 2001.
The Company is a purchaser of certain base metals (such as copper), precious metals and energy. The Company maintains a commodity price risk management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations caused by commodity price volatility. The commodity price derivatives that the Company enters into are concluded as cash flow hedges to offset forecasted purchases.

Credit risk represents the loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. As of December 31, 2001, the Company identified 3 customers with significant exposure. This exposure amounts to EUR 201 million in total and ranges from EUR 58 million to EUR 79 million per customer. To reduce exposure to credit risk, the Company performs ongoing credit evaluations of the financial condition of its customers but generally does not require collateral.
The Company invests available cash and cash equivalents with various financial institutions.
The Company is also exposed to credit risks in the event of non-performance by counterparties with respect to derivative financial instruments. The Company does not enter into any derivative financial instruments to protect against default by financial counterparties. However, the Company requires, in principle, that financial counterparties with which it deals in derivative transactions complete legally enforceable set-off agreements prior to trading and, whenever possible, have a strong credit rating from Standard & Poor's and Moody's Investor Services. It is the Company's policy to conclude financial transactions, where possible, under an ISDA (International Swap Dealers Association) master agreement. Wherever possible, cash is invested and financial transactions are concluded with financial institutions with strong credit ratings.

Proxy solicitation

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

Philips will use the Shareholders' Communication Channel to distribute the Management Report booklet of its Annual Report and the Agenda for this year's General Meeting of Shareholders. As in 2001, Philips will use a proxy solicitation system in the Netherlands for this year's General Meeting of Shareholders; a voting instruction form will be distributed via the Shareholders' Communication Channel. For the General Meeting of Shareholders on March 28, 2002, a record date (being March 21, 2002) will apply: those persons who on March 21, 2002 hold shares in the Company and are registered as such in one of the registers designated by the Board of Management for the General Meeting of Shareholders will be entitled to participate and vote at the meeting.

Philips is convinced of the value of the Shareholders' Communication Channel and will continue to advocate its widespread adoption. In a broader context, Philips is constantly striving to improve its contacts with the financial community at large.

Environmental performance

Philips initiated a pragmatic approach in 1994 and defined measurable targets, laid down in four-year action programs. The most recent four-year program, running from 1998 until year-end 2001, is called EcoVision. Details of Philips' environmental policy and of the progress made in implementing EcoVision in 2001 are to be found in the separate Corporate Environmental Report.

Under the EcoVision program, Green Flagships, or 'green' star products, are developed. These are products with a better environmental performance than predecessors or competitors in one or more of five Green Focal Areas – weight, hazardous substances, energy consumption, packaging and recyclability. The results for 2001 show that 74 Philips products were identified as Green Flagships, of which 48 were marketed as such.

It should be noted that the comparability of the data given below for the reporting period and previous years is affected by changes to the portfolio of reporting units.

Compared with the reference year 1994, energy saving improved from 27% in 1999 to 31% in 2000, declining to 24% in 2001. For industrial waste, savings of 60% were realized in 2001, compared with 58% in 2000 and 45% in 1999. Water consumption was reduced by 50%, compared with 45% in 2000 and 41% in 1999.
Of the manufacturing sites, 92% are certified and manage their activities in accordance with the internationally accepted environmental standards ISO 14001 or EMAS (85% in 2000; 75% in 1999).

Information technology

Philips.com

Over the last few years the number of web initiatives at Philips has increased rapidly, creating a very diverse Internet presence. In 2001, the relaunch – with a standard template – of www.philips.com ensured that Philips presented a new 'single face' on the Internet. The ongoing program focuses on improving the gateway to Philips' businesses and ensuring a coherent, balanced and consistent expression of Philips' brand presence through the introduction of standards, guidelines and templates.

IT strategy consolidation

In 2001 the IT strategies of all product divisions and corporate departments were analyzed for cross-organizational opportunities and consolidated in a Philips Group IT Strategy and Plan. It is expected that consolidation will make the total portfolio of IT activities across the Philips Group more transparent and will make it easier to define opportunities to share solutions, work together and deliver cost savings.

e-Business security

Trading via the Internet is inherently more risky than traditional business. Maintaining the integrity of transactions and the availability of critical systems is a major challenge. Our e-business security policy and organization, defined to counterbalance these business risks, were successfully deployed in 2001 in fighting an increasing number of cyber-attacks. The lessons learned from these virus attacks have been used to improve security policy and organization and to enhance prevention, detection and correction measures for both virus attacks and hacking attempts.

Internet website consolidation

Early 2000, the migration of Philips Internet websites to a new shared Internet Data Center (IDC) was started. By the end of 2001 this project was completed. The Internet websites of all Philips organizations are now running in the IDC, enjoying a stable, reliable, secure and scaleable environment, integration with existing infrastructure and systems, connections to the Internet, security services, shared hardware, access to the Philips Global Network and technical support.

IT implications of divestments, mergers and acquisitions

A number of companies divested from Philips are still closely coupled to our corporate IT infrastructure. In 2001, 'disentanglement' contracts were developed to ensure orderly disengagement from this infrastructure. These contracts strike a balance between limiting continued dependency on Philips' IT investment and negatively impacting the value of the company being divested. Merger and acquisition checklists for assessing the value or risks inherent in a company's technical infrastructure, applications portfolio and contractual relationships with suppliers have been improved. They also provide a better framework for analyzing the complexity and cost of integrating a new company into Philips' standard IT infrastructure.

Human Resources Management

In 2001 the labor markets lost some of the severe tension that was characteristic of the previous year. Competition for top talent for business leadership positions remained fierce, however. Philips holds a strong competitive position on the labor market: the technological base, the global brand and the challenging industry attract talent across the world. In the markets for technical specialists, the changes in the economic climate were most clearly reflected in the growth of the supply of people.

The worldwide program HR Excellence 2002, which was launched in 2000, was deployed throughout the Company's managerial ranks in the reporting year. Renewed and coherent policies, processes and tools for management development have been implemented in a comprehensive program of workshops.

Processes aimed at achieving excellence in the way HR management is conducted throughout the organization have been implemented. In this respect, the BEST program, which serves as the driver of business excellence at Philips, is applied to the HR function as it is used in the businesses. A comprehensive 'HR for HR' program has been started to ensure world-class professionalism in the HR organization.

Leadership development has been further intensified. The existing programs based on the Philips Leadership Competencies have been upgraded and a number of new ones have been launched. In particular, the deployment of 360 degrees assessment, combined with intensive coaching, has been taken further into the executive population and beyond. Philips sees particularly effective outcomes from this form of leadership development. We will take this process further in the next year, in order to give a yet larger group of business leaders an opportunity to develop their leadership competence.

In order to maintain our competitiveness in a number of relevant labor markets, the performance-related stock option program for executives has been further deployed to a select group of individuals below the executive ranks (approximately 10,500).

Business Excellence

In 2001 we made further progress in implementing BEST (Business Excellence through Speed and Teamwork), our company-wide improvement drive aimed at achieving world-class excellence in every aspect of the business.

Businesses in Philips are gaining more experience in deploying the Business Balanced Scorecard as a key tool for management to focus improvement efforts. A recently installed online communication system for the balanced scorecard helps management to monitor the evolution of the businesses' most critical success factors and also to review the progress of the key improvement actions. More and more, the balanced scorecard serves not only as the starting point for identifying those areas where breakthroughs in performance are most needed, but also as an instrument for tracking progress.

We are also widely implementing our Process Survey Tool approach. The maturity of operational processes is assessed twice per year by those directly involved in these processes with the help of dedicated survey tools. This approach is proving to be an effective driver of continuous improvement. We are experiencing the same effect at business level, where most management teams have now conducted several cycles of annual self-assessment of Business Excellence (based on the EFQM model). Validation of these assessments by peers reinforces the improvement process by providing cross-business exposure to leadership practice.

Outlook

Economic conditions around the world continue to point to a limited growth environment. Improvement in results in 2002 will come mainly from cost reductions, efficiency improvements and restructuring programs, many of which were already initiated in 2001, as well as ongoing portfolio management.
As a consequence of weakness in the stock markets, we anticipate a significant reduction of pension credits in our results throughout 2002.

The severe declines of the IT and telecommunication markets, which were so damaging in 2001, have now stopped, and excess inventories, both at customers and in the industry, have mostly disappeared. In general, we do not see markets strengthening, therefore we maintain a cautious stand on costs, capital spending, working capital and employment in 2002.
The Company has been streamlined and focused during the downturn and is in a good position to be an early beneficiary of any upturn in its markets.

February 5, 2002
Board of Management

Accounting policies

The consolidated financial statements are prepared on a basis consistent with generally accepted accounting principles in the Netherlands ('Dutch GAAP'). Historical cost is used as the measurement basis unless otherwise indicated.

Presentation changes

In order to better reflect the nature of Philips as a technology company and to gain insight into the composition of income from operations, the presentation on the face of the consolidated statements of income has changed.

- Research and Development (R&D) costs and charges recorded with respect to acquired in-process R&D are excluded from the line cost of sales and are presented separately;
- Impairment charges are also excluded from the line cost of sales and are presented with restructuring charges on the line restructuring and impairment charges;
- Amortization of goodwill and other intangibles and interest income and expenses are disclosed separately.

Comparative figures of previous years have been reclassified to conform with the current-year presentation.

Consolidation principles

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

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

Foreign currencies

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

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

Derivative financial instruments

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

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

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

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

Cash and cash equivalents

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

Securities

Securities designated as available for sale are carried at the lower of cost or market value. Gains or losses, if any, are recorded in financial income and expenses.
Securities hedged under a fair value hedge are remeasured for the changes in the fair value that are attributable to the risk which is being hedged.

Receivables

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

Inventories

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

Other non-current financial assets

Loans receivable are carried at face value, less a provision for doubtful accounts.
Long-term investments in equity securities are carried at cost or are written down to fair value if an other-than-temporary decline in value exists.

Property, plant and equipment

Property, plant and equipment are carried at cost, less accumulated depreciation. Assets manufactured by the Company include direct manufacturing costs, production overheads and interest charges incurred during the construction period. Government grants are deducted from the cost of the related asset. Depreciation is calculated using the straight-line method over the expected economic life of the asset. Depreciation of special tooling is based on the expected future economic benefit of these tools. Gains and losses on the sale of property, plant and equipment are included in other business income. Costs related to major maintenance activities are expensed in the period in which they are incurred.

Intangible assets

Intangible assets, including goodwill arising from acquisitions, are amortized using the straight-line method over their estimated economic lives, not exceeding twenty years.
In-process Research and Development (R&D) is written off immediately upon acquisition.
Patents and trademarks acquired from third parties are capitalized and amortized over their remaining lives.

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

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

Impairment of intangible and tangible fixed assets

Intangible and tangible fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Provisions

The Company recognizes provisions for liabilities and losses which have been incurred as of the balance sheet date and for which the amount is uncertain but can be reasonably estimated. Additionally, the Company records provisions for losses which are expected to be incurred in the future, but which relate to contingencies that exist as of the balance sheet date.

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

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

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

Debt and other liabilities

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

Revenue recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Generally, these criteria are met at the time the product is shipped or services are rendered and acceptance, when required, has been obtained. Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. Service revenue is recognized over the contractual period or as services are rendered. Revenues from long-term contracts are recognized in accordance with the percentage-of-completion method.
Provision for estimated contract losses, if any, is made in the period that such losses are determined. Royalty income, which is generally payable based upon a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis. Government grants, other than those relating to assets, are recognized as income as qualified expenditures are made.

Financial income and expenses

Interest income and interest expense are recognized on an accrual basis.

Income taxes

Income tax expense is based on pre-tax financial accounting income and comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to an item recognized directly to equity, in which case it is recognized in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Measurement of deferred tax assets and liabilities is based upon the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets, including assets arising from loss carryforwards, are recognized if it is more likely than not that the asset will be realized. Deferred tax assets and liabilities are not discounted.

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

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

Benefit accounting

The Company accounts for the cost of pension plans and postretirement benefits other than pensions in accordance with SFAS No. 87, ‘Employers’ Accounting for Pensions’, and SFAS No. 106, ‘Postretirement Benefits other than Pensions’, respectively.
Most of the Company’s defined-benefit plans are funded with plan assets that have been segregated and restricted in a trust to provide for the pension benefits to which the Company has committed itself.
When plan assets have not been segregated by the Company or in such cases in which the Company is required to make additional pension payments, the Company recognizes a provision for such amounts.
Pension costs, in respect of defined-benefit pension plans, primarily represent the increase in the actuarial present value of the obligation for pension benefits based on employee service during the year and the interest on this obligation in respect of employee service in previous years, net of the expected return on plan assets.

In the event that at any date the accumulated benefit obligation, calculated as the present value of the benefits attributed to employee service rendered prior to that date and based on current and past compensation levels, would be higher than the market value of the plan assets or the existing level of the pension provision, the difference is immediately recognized as an additional liability.

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

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

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

Stock-based compensation

The Company accounts for stock-based compensation using the intrinsic value method in accordance with Dutch GAAP, which is also in conformity with US Accounting Principles Board (APB) Opinion No. 25, 'Accounting for Stock Issued to Employees'. The Company has adopted the pro forma disclosure requirements of SFAS No. 123, 'Accounting for Stock-Based Compensation'.

Discontinued operations

Any gain or loss from disposal of a segment of a business (product sector), together with the results of these operations until the date of disposal, are reported separately as discontinued operations. The financial information of a discontinued segment of business is excluded from the respective captions in the consolidated financial statements and related notes.

Extraordinary income and losses

Extraordinary items include transactions which occur infrequently and are unrelated to the ordinary and typical activities of the Company.

Cash flow statements

Cash flow statements have been prepared under the indirect method in accordance with Dutch GAAP, which is in conformity with the requirements of SFAS No. 95, 'Statement of Cash flows', and the amendment, SFAS No. 104. Cash flows resulting from hedges are presented in the same category as the hedged items. Cash flows in foreign currencies have been translated into euros using the average rates of exchange for the periods involved. Cash flows resulting from the acquisition or sale of securities are reported under cash flows from investing activities.

Distribution to shareholders

The proposed distribution to shareholders from the other reserves (according to article 38, paragraph 1 of the Articles of Association), which is subject to approval by the General Meeting of Shareholders, is recorded when such approval is received.

Use of estimates

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

New accounting standards

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, 'Business Combinations', and SFAS No. 142, 'Goodwill and Other Intangible Assets'.

SFAS No. 141 requires the use of the purchase method of accounting for all business combinations initiated after June 30, 2001. SFAS No. 141 also specifies certain criteria that intangible assets must meet to be recognized apart from goodwill.

Under SFAS No. 142, goodwill will no longer be amortized on a straight-line basis over its estimated useful life, but will be tested for impairment on an annual basis and whenever indicators of impairment arise. The goodwill impairment test, which is based on fair value, is to be performed on a reporting unit level. A reporting unit is defined as an operating segment under SFAS No. 131, 'Disclosures about Segments of an Enterprise and Related Information' or one level lower. Goodwill will no longer be tested for impairment under SFAS No. 121, 'Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of'. Additionally, goodwill on equity method investments will no longer be amortized; however, it will continue to be tested for impairment in accordance with APB Opinion No. 18, 'The Equity Method of Accounting for Investments in Common Stock'. Under SFAS No. 142, intangible assets with indefinite lives will not be amortized. Instead they will be carried at the lower of cost or market value and tested for impairment at least annually. All other recognized intangible assets will continue to be amortized over their estimated useful lives. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001 although goodwill on business combinations consummated after June 30, 2001 will not be amortized. On adoption the Company may be required to record a cumulative effect adjustment to reflect the impairment of previously recognized intangible assets. In addition, goodwill on prior business combinations will cease to be amortized. Goodwill amortization in 2001 totaled EUR 583 million. The Company has not yet determined the impact that these Statements will have on intangible assets or whether a cumulative effect adjustment will be required upon adoption. The initial impairment tests will be performed in the first half of 2002.

Also in June 2001, the FASB issued SFAS No. 143, 'Accounting for Asset Retirement Obligations'. This Statement requires that the fair value of an asset retirement obligation be recognized in the period in which it is incurred and be capitalized as part of the carrying amount of the long-lived asset. Previously, accounting practices were diverse. This Standard will become effective for fiscal years beginning after June 15, 2002. Upon adoption, the Company may be required to record a cumulative effect adjustment related to the recognition of such obligations. The Company has not yet determined the impact that this Statement will have on liabilities and long-lived assets and whether a cumulative effect adjustment will be required upon adoption.

In August 2001, the FASB issued SFAS No. 144, 'Accounting for the Impairment or Disposal of Long-Lived Assets'. This Statement replaces SFAS No. 121, 'Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of', and also amends several other existing standards. SFAS No. 144 retains most of the requirements of SFAS No. 121. However, it requires that long-lived assets to be disposed of other than by sale continue to be depreciated, whereas SFAS No. 121 did not require such.

Furthermore, SFAS No. 144 requires that a component of an entity for which operations and cash flows can be clearly distinguished operationally and for financial reporting purposes, and which has been disposed of or is classified as held for sale, be reported in discontinued operations, whereas APB Opinion No. 30 required this only for a reportable segment, i.e. a product sector. The Company expects to designate its Businesses, which are one level below product sector level, as components. SFAS No. 144 will become effective for fiscal years beginning after December 15, 2001. The Company expects the impact of the adoption of SFAS No. 144, in sofar as it replaces SFAS No. 121, to be insignificant.

Possible change in accounting principles

In anticipation of possible new regulations in the Netherlands, which would enable companies to adopt internationally recognized accounting principles, the Company is considering changing over to full US GAAP reporting in 2002.

As in previous years, a reconciliation of net income and stockholders' equity, determined in accordance with US GAAP and Dutch GAAP is provided in note 27 to these financial statements.

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

in millions of euros unless otherwise stated

Note			2001		2000		1999
	Sales		**32,339**		37,862		31,459
	Cost of sales:						
	- amortization of goodwill and other intangibles	**(371)**		(263)		(147)	
	- other costs of sales	**(22,814)**		(25,579)		(21,962)	
			(23,185)		(25,842)		(22,109)
	Gross income		**9,154**		12,020		9,350
	Selling expenses	**(5,027)**		(4,960)		(4,337)	
	General and administrative expenses	**(1,230)**		(1,298)		(1,212)	
	Research and development expenses	**(3,312)**		(2,766)		(2,284)	
	Write-off of acquired in-process R&D	**(106)**		(44)		(68)	
	Restructuring and impairment charges	**(1,093)**		(197)		(86)	
			(10,768)		(9,265)		(7,987)
	Other business income – net		**243**		1,526		388
2	**Income (loss) from operations**		**(1,371)**		4,281		1,751
3	Financial income and expenses:						
	- interest	**(391)**		(167)		(129)	
	- other	**(524)**		2,155		161	
			(915)		1,988		32
	Income (loss) before taxes		**(2,286)**		6,269		1,783
4	Income taxes		**421**		(570)		(336)
	Income (loss) after taxes		**(1,865)**		5,699		1,447
5	Results relating to unconsolidated companies:						
	- income excluding amortization of goodwill and other intangibles	**(387)**		4,094		458	
	- amortization of goodwill and other intangibles	**(367)**		(124)		(49)	
			(754)		3,970		409
	Group income (loss)		**(2,619)**		9,669		1,856
6	Minority interests		**15**		(67)		(52)
	Income (loss) from continuing operations		**(2,604)**		9,602		1,804
7	**Extraordinary items – net**		**–**		–		(5)
8	**Net income (loss)**		**(2,604)**		9,602		1,799

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

Earnings per share

	2001	2000	1999
Weighted average number of common shares outstanding (after deduction of treasury stock) during the year (in thousands)	**1,278,077**	1,312,859	1,378,041
Basic earnings per common share in euros:			
Income (loss) from continuing operations	**(2.04)**	7.31	1.31
Net income (loss)	**(2.04)**	7.31	1.31
Diluted earnings per common share in euros*:			
Income (loss) from continuing operations	**(2.04)**	7.24	1.30
Net income (loss)	**(2.04)**	7.24	1.30
Dividend paid per common share in euros (from prior-year profits)	**0.36**	0.30	0.25

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

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

Consolidated balance sheets of the Philips Group as of December 31

in millions of euros unless otherwise stated

The consolidated balance sheets are presented before appropriation of profit

Assets

Note			2001		2000
	Current assets				
	Cash and cash equivalents		**890**		1,089
9	Securities		**130**		111
10	Receivables:				
	- Accounts receivable – net	**5,298**		5,905	
	- Accounts receivable from unconsolidated companies	**122**		56	
	- Other receivables	**392**		539	
	- Prepaid expenses	**342**		306	
			6,154		6,806
11	Inventories		**4,290**		5,279
	Total current assets		**11,464**		13,285
	Non-current assets				
5	Unconsolidated companies:				
	- Investments	**5,170**		4,793	
	- Loans	**462**		535	
			5,632		5,328
12	Other non-current financial assets		**2,789**		3,747
13	Non-current receivables:				
	- Accounts receivable – net	**149**		143	
	- Accounts receivable from unconsolidated companies	**1**		3	
	- Other receivables	**156**		157	
	- Prepaid expenses	**3,276**		2,410	
			3,582		2,713
14	Property, plant and equipment:				
	- At cost	**18,069**		20,265	
	- Less accumulated depreciation	**(10,351)**		(11,224)	
			7,718		9,041
15	Intangible assets – net		**7,269**		4,427
	Total non-current assets		**26,990**		25,256
	Total		**38,454**		38,541

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

Note			2001		2000
	Current liabilities				
	Accounts and notes payable:				
	- Trade creditors	3,240		4,250	
	- Unconsolidated companies	3		5	
			3,243		4,255
16	Accrued liabilities		4,137		3,701
17 18	Short-term provisions		1,456		969
19	Other current liabilities		813		862
20 22	Short-term debt		1,271		1,743
	Total current liabilities		10,920		11,530
	Non-current liabilities				
21 22	Long-term debt		6,595		2,284
17 18	Long-term provisions		2,284		2,522
	Total non-current liabilities		8,879		4,806
23	Commitments and contingent liabilities		–		–
	Group equity				
6	Minority interests		202		469
24	Stockholders' equity:				
	Priority shares, par value EUR 500 per share:				
	Authorized and issued: 10 shares				
	Preference shares, par value EUR 0.20 per share:				
	Authorized: 3,249,975,000 shares				
	- Issued: none				
	Common shares, par value EUR 0.20 per share:				
	Authorized: 3,250,000,000 shares				
	- Issued: 1,316,070,392 shares (1,316,070,392 shares in 2000)				
	- Treasury: 41,897,949 shares (32,175,659 shares in 2000)	263		263	
	Share premium	13		7	
	Other reserves	20,781		11,864	
	Profit (loss) for the year	(2,604)		9,602	
			18,453		21,736
	Total		38,454		38,541

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

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

in millions of euros unless otherwise stated

	2001	2000	1999
Cash flows from operating activities:			
Net income (loss)	**(2,604)**	9,602	1,799
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**2,797**	2,320	1,853
Net gain on sale of investments	**(378)**	(6,384)	(491)
(Income) loss from unconsolidated companies (net of dividends received)	**676**	(1,187)	(410)
Minority interests (net of dividends paid)	**(21)**	56	38
Decrease (increase) in working capital	**1,080**	(1,069)	(469)
Increase in non-current receivables	**(874)**	(510)	(32)
Increase (decrease) in provisions	**287**	386	(87)
Other items	**285**	(218)	(288)
Net cash provided by operating activities	**1,248**	2,996	1,913
Cash flows from investing activities:			
Purchase of intangible assets (software)	**(234)**	(140)	(200)
Capital expenditures on property, plant and equipment	**(2,143)**	(3,170)	(1,662)
Proceeds from disposals of property, plant and equipment	**221**	178	286
(Purchase) proceeds from the sale of securities available for sale	**(1)**	848	158
Purchase of other non-current financial assets	**(76)**	(560)	(119)
Proceeds from other non-current financial assets	**550**	63	67
Purchase of businesses	**(3,636)**	(3,209)	(2,993)
Proceeds from sale of interests in businesses	**755**	3,586	629
Net cash used for investing activities	**(4,564)**	(2,404)	(3,834)
Cash flows before financing activities	**(3,316)**	592	(1,921)
Cash flows from financing activities:			
(Decrease) increase in short-term debt	**(73)**	734	(257)
Principal payments on long-term debt	**(554)**	(325)	(563)
Proceeds from issuance of long-term debt	**4,580**	203	103
Treasury stock transactions	**(336)**	(578)	(38)
Capital repayment to shareholders	**–**	(1,673)	(1,490)
Dividends paid	**(458)**	(399)	(361)
Net cash provided by (used for) financing activities	**3,159**	(2,038)	(2,606)
Cash used for continuing operations	**(157)**	(1,446)	(4,527)
Effect of changes in exchange rates and consolidations on cash positions	**(42)**	204	305
Cash and cash equivalents at beginning of year	**1,089**	2,331	6,553
Cash and cash equivalents at end of year	**890**	1,089	2,331

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

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

Supplemental disclosures to consolidated statements of cash flows:

	2001	2000	1999
Decrease (increase) in working capital:			
Decrease (increase) in accounts receivable and prepaid expenses	**1,207**	(513)	(534)
Decrease (increase) in inventories	**790**	(979)	46
(Decrease) increase in accounts payable and accrued expenses	**(917)**	423	19
	1,080	(1,069)	(469)
Net cash paid during the year for:			
Interest	**391**	167	129
Income taxes	**355**	266	222
Net gain on sale of investments:			
Cash proceeds from the sale of investments	**1,526**	4,675	1,140
Book value of these investments	**(1,190)**	(875)	(649)
Non-cash gains	**42**	2,584	–
	378	6,384	491
Non-cash investing and financing information:			
Assets received in lieu of cash	**63**	2,589	11
Treasury stock transactions:			
Shares acquired	**(379)**	(682)	(139)
Exercise stock options/warrants/convertible personnel debentures	**43**	104	101

For a number of reasons, principally the effects of translation differences and consolidation changes, certain items in the statements of cash flows do not correspond to the differences between the balance sheet amounts for the respective items.

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

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

in millions of euros unless otherwise stated

	number of shares		issued, paid-up capital	share premium	other reserves	treasury shares	total
	outstanding	issued					
Balance as of December 31, 1998	1,442,760,868	1,473,979,296	1,672	1,824	11,587	(523)	14,560
Issued upon exercise of:							
- Convertible debentures		276,324		2	27		29
- Stock options		80		(11)			(11)
Net income for the year					1,799		1,799
Dividend paid					(361)		(361)
Treasury stock transactions					(55)	28	(27)
8% share reduction		(117,940,456)	(1,333)	(184)		27	(1,490)
Translation differences and other changes					258		258
Balance as of December 31, 1999	1,331,600,540	1,356,315,244	339	1,631	13,255	(468)	14,757
Change in accounting policy:							
- Product/process development costs previously included in inventories					(241)		(241)
- Derivatives (SFAS 133)					58		58
Issued upon exercise of:							
- Convertible debentures		458,356		6	7		13
Net income for the year					9,602		9,602
Dividend paid					(399)		(399)
Treasury stock transactions					(23)	(555)	(578)
3% share reduction		(40,703,208)	(76)	(1,630)	(8)	41	(1,673)
Translation differences and other changes					197		197
Balance as of December 31, 2000	1,283,894,733	1,316,070,392	263	7	22,448	(982)	21,736
Net income (loss) for the year					(2,604)		(2,604)
Dividend paid					(458)		(458)
Additional paid-in capital stock options				6			6
Treasury stock transactions					(21)	(312)	(333)
Translation differences and other changes					106		106
Balance as of December 31, 2001	**1,274,172,443**	**1,316,070,392**	**263**	**13**	**19,471**	**(1,294)**	**18,453**

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

Notes to the consolidated financial statements of the Philips Group

all amounts in millions of euros unless otherwise stated

Introduction

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

Presentation of financial statements

The current balance sheet presentation is different from the one used under Dutch regulations and is more in line with common practice in the United States in order to accommodate the expectations of foreign – mainly US – shareholders. Under the current format, the order of presentation of assets and liabilities is based on the degree of liquidity.

1 Acquisitions and divestments

A summary of the most significant acquisitions and divestments during 2001 is given below.

Marconi

In October 2001, Philips acquired all the shares of Marconi's Medical Systems business, which comprises two businesses, the core Medical Imaging Equipment business, a global participant in the medical diagnostic imaging equipment industry, and the Marconi Healthcare Products business (HCP), one of the largest distributors of radiology imaging supplies in the USA. Philips intends to divest HCP. The acquisition price of Marconi Medical Systems was EUR 1.2 billion in cash. The primary reasons for the acquisition were to enhance Medical Systems' computed tomography (CT) portfolio and to acquire an additional CT installed base whose service and maintenance is the most profitable area of the diagnostic imaging industry. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. The allocation includes the cost of planned restructuring associated with certain existing activities and involuntary termination costs. Based upon an independent appraisal, EUR 338 million was assigned to specific intangible assets acquired, including purchased technology and in-process R&D. Of this amount, EUR 51 million, representing the value of in-process R&D that had not yet reached technological feasibility and had no alternative use, was charged to expense as of the date of acquistion. Additionally, EUR 556 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. All goodwill has been recorded in the Medical Systems segment. In accordance with Dutch GAAP, goodwill is being amortized over 15 years. Most of the goodwill will be tax-deductible. The intangible assets, other than goodwill, are not expected to have a residual value at the end of their respective useful lives. The weighted average amortization period for customer-related intangible assets is 15 years and for technology-based intangible assets 10 years, which averages approximately 12.5 years for all intangibles other than goodwill. No intangible assets with indefinite lives have been recognized. The results of operations for Marconi's Medical Systems business have been included in the Company's consolidated financial statements as from October 19, 2001.

The elements of the purchase price, converted into euros using the exchange rate at acquisition date, have been allocated to the net assets of Marconi Medical Systems as follows:

Total purchase price	1,245
Allocated to:	
Property, plant and equipment	177
Net working capital	265
Restructuring liability	(91)
Developed product technology	96
Core technology	48
In-process R&D	51
Customer relationships	143
Goodwill	556

The allocation of the purchase price to the net assets acquired had not yet been completely finalized at year-end 2001.

In addition to the acquisition of Marconi's Medical Systems, Philips has agreed to enter into a five-year technology supply partnership with Marconi, under which Philips will purchase up to USD 150 million of equipment and services covering a broad range of Marconi's communications solutions.

Lighting

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

Agilent

In August 2001, Philips completed the acquisition of the net assets of Agilent Technologies Inc.'s Healthcare Solutions Group (HSG) for a total purchase price of EUR 2.0 billion in cash. HSG is active in the field of pervasive cardiology and monitoring solutions, and is a leading global provider of medical products and services to hospitals, healthcare clinics, physicians' offices, airlines and others. The primary reason for the acquisition was to enhance our existing business and to provide Medical Systems with a strong position in the cardiac sector. Additionally, the acquisition enables Medical Systems to enter certain new, high-growth segments such as home care technology enabling remote diagnostics. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. Based upon an independent appraisal, EUR 421 million was assigned to specific intangible assets acquired, including purchased technology and in-process R&D. Of this amount, EUR 55 million, representing the value of in-process R&D that had not yet reached technological feasibility and had no alternative use, was charged to expense as of the date of acquisition.

Additionally, EUR 1,032 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. All goodwill has been recorded in the Medical Systems segment. Most of the goodwill will be tax-deductible. In accordance with Dutch GAAP, goodwill is being amortized over 15 years. The intangible assets, other than goodwill, are not expected to have a residual value at the end of their respective useful lives. The weighted average amortization period for customer-related intangible assets is 15 years and for technology-based intangible assets 10 years, which averages approximately 12.5 years for all intangibles other than goodwill. No intangible assets with indefinite lives have been recognized. As of August 1, 2001, the results of operations for Agilent have been included in Philips' consolidated financial statements.
The elements of the purchase price, converted into euros using the exchange rate at acquisition date, have been allocated to the net assets of HSG as follows:

Total purchase price*	2,049
Allocated to:	
Property, plant and equipment	125
Net working capital	473
Restructuring liability	(2)
Developed product technology	139
Core technology	59
In-process R&D	55
Customer relationships	168
Goodwill	1,032

* of which EUR 106 million is recorded under accrued expenses.

The allocation of the purchase price to the net assets acquired had not yet been completely finalized at year-end 2001.

LG.Philips Displays

In June 2001, Philips and LG Electronics (LGE) completed a definitive agreement through which the two companies merged their respective cathode ray tube (CRT) businesses into a new joint venture company. LGE and Philips share equal control of the joint venture. The joint venture remitted USD 1.1 billion in cash to LGE and USD 0.3 billion to Philips to close the difference in the valuation of the net assets contributed.
The investment is accounted for using the equity method. The excess of the Company's investment over its underlying equity in the recognized net assets, commonly referred to as goodwill under Dutch GAAP, is EUR 801 million. This excess is being amortized over the average remaining useful lives of the non-current assets that have been contributed to the joint venture, determined in proportion to the relative excess of the fair values over the historical cost basis of all assets contributed to the joint venture, which is 4.5 years. As from July 2, 2001, the CRT businesses are no longer consolidated in the Company's financial statements. Sales of Philips' CRT businesses amounted to EUR 1,994 million and EUR 1,765 million for the years ended December 31, 2000 and 1999 respectively, and EUR 686 million for the six months ended June 30, 2001.

Philips' assets and liabilities transferred to the new joint venture are as follows:

Current assets	684
Non-current assets	1,685
Total assets	2,369
Other liabilities	(785)
Provisions	(43)
Intercompany financing	33
Net assets	1,574

No gain or loss has been recognized at the formation of the joint venture.

The LG.Philips Displays joint venture comprises approximately 75 organizations in 25 countries. For local statutory, fiscal and contractual purposes, individual assets and liabilities in each legal entity have to be valued and audited. As the valuation process has not yet been completed, the joint venture's opening balance sheet and its current-year results have not yet been finalized. Parties are having discussions on certain valuation principles which, if not resolved, could be submitted for arbitration. Consequently, certain estimates have been used to account for Philips' investment in this joint venture and the share in its earnings.
Due to heavy capital expenditures, the weak markets for CRTs and the high cost of integration, the joint venture requires additional financing. Both partners have agreed in principle to inject additional equity for a total aggregate amount of USD 250 million.

Philips Consumer Communications

In October 2001, Philips announced it had signed a definitive agreement with respect to a transfer of Philips' mobile handset activities to China Electronics Corporation (CEC). Under the agreement, Philips will contribute part of the research & development and manufacturing activities of Philips Consumer Communications (PCC) into a partnership with CEC. Philips will maintain a focused sales and marketing activity in mobile telephony under the Philips brand.
In December 2001, 65% of the shares in the manufacturing company in China were transferred to the CEC group, bringing their ownership to 75%. Therefore, at year-end this company was deconsolidated. The transfer of 100% of the shares in the development company in France is expected to be completed in the first quarter of 2002. Given that both transactions are related, any gain on the total transaction will be recognized when the share transfer in the development company is completed.
Part of the Le Mans manufacturing operations that remained after the restructuring of PCC has been sold to European Telecom plc; the transaction was closed on December 31, 2001, therefore the operations have been deconsolidated as of December 31, 2001.

FEI

In May 2001, Philips reduced its stake in FEI Company to 25.5% through a public offering of FEI shares and through the sale of approximately 6 million shares owned by Philips. The cash proceeds were EUR 200 million, resulting in a gain of EUR 185 million included in other business income.
Following the offering, Philips no longer consolidates the financial data of FEI, previously included in the product sector Miscellaneous. The remaining investment is accounted for as an equity investment from May 2001 onwards.

Philips Broadcast

In February 2001, Philips sold its Broadcast group to Thomson Multimedia of France for a cash amount of EUR 165 million, of which EUR 63 million will be received in 2002 and 2003. In relation to this sale a gain was recognized, net of cost of disposal, of EUR 57 million, which is included in other business income.

Other

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

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

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

The most significant acquisitions and divestments during 2000 and 1999 were as follows:

TSMC preferred stock

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

ADAC

In December 2000, Philips acquired substantially all of ADAC Laboratories' common stock for USD 18.50 per share for each outstanding share. The total purchase price was EUR 483 million. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and the liabilities assumed. Based upon an independent appraisal, EUR 241 million was assigned to specific intangible assets acquired, including purchased technology, in-process R&D, the value of the customer base and the value of the existing workforce. Of this amount, EUR 44 million, representing the value of in-process R&D that had not yet reached technological feasibility and had no alternative future use, was charged to expense as of the date of acquisition. An amount of EUR 257 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. Goodwill and other intangibles are being amortized over their useful lives, which average approximately 13 years.

MedQuist

During 2000, in a series of transactions, Philips acquired approximately 71% of the outstanding shares in MedQuist, a provider of electronic medical transcription services in the United States, for a total aggregate cash purchase price of EUR 1,339 million. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. Based upon an independent appraisal, EUR 207 million was assigned to specific intangible assets acquired, including the value of the customer base and the existing workforce. An amount of EUR 1,097 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. Goodwill and other intangibles are being amortized over their useful lives, which average approximately 15 years. The results of operations for MedQuist have been included in the Company's consolidated financial statements as from July 1, 2000.

Optiva

In October 2000, Philips acquired all of the outstanding shares of Optiva Corporation, the manufacturer of the Sonicare toothbrush, at a cost of EUR 291 million. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. Based upon an independent appraisal, EUR 99 million was assigned to specific intangible assets acquired, including patents and trademarks and the value of the workforce. Additionally, EUR 182 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. The intangible assets are being amortized over their estimated useful lives, which average approximately 14.5 years. As from October 1, 2000, the results of operations for Optiva have been included in the Company's consolidated financial statements.

Philips has changed the name of Optiva into Philips Oral Healthcare with effect from 2001.

MiCRUS

In June 2000, Philips purchased IBM's MiCRUS 8-inch wafer fab in the USA, a semiconductor activity, for which the results of operations have been included in the consolidated financial statements as from June 1, 2000. The acquisition price was EUR 378 million, of which approximately EUR 340 million was paid through December 31, 2001. Based upon an independent appraisal, EUR 367 million was assigned to the fixed assets acquired and EUR 11 million was assigned to the value of the existing workforce.

Atos Origin

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

Additionally, Philips received two tranches of warrants, each representing approximately 2.4 million Atos Origin shares. These warrants may be exercised in the event the weighted average share price of Atos Origin exceeds EUR 156 per share for twelve consecutive business days within 20 months following the closing date for the first tranche, and EUR 208 per share within 32 months for the second tranche. As from October 1, 2000, Philips no longer consolidates Origin as a separate division, but, under the equity method of accounting, includes its share in Atos Origin's earnings in results relating to unconsolidated companies from January 1, 2001 onwards. Due to Atos Origin's different reporting cycle, Philips' share can only be accounted for on a three-month-delay basis.

The Company adjusted its investment in Origin to equal its share of the post-transaction merged equity of Atos Origin, based on Philips' accounting policies, resulting in a gain of EUR 1,072 million, which is included in other business income.
Philips limited its voting rights to 35% and has the intention to reduce its stake in Atos Origin below 35% (directly or indirectly) within two years after the closing date, subject to market conditions being acceptable.

AC&M

In May 2000, Philips reached agreement with Yageo Corporation of Taiwan to sell its AC&M (Advanced Ceramics & Modules) business to Yageo Corporation.
The transaction was completed in August 2000, and the Company received cash proceeds of EUR 658 million and recognized a gain, net of cost of disposal, of EUR 309 million (net of taxes EUR 247 million), which is included in other business income. Sales and income related to this business included in the consolidated statement of income for 2000 totaled EUR 239 million and EUR 41 million respectively.

LG.Philips LCD Co., LTD

With effect from July 1, 1999, Philips and LG Electronics of South Korea finalized a manufacturing joint venture agreement, creating a world-leading supplier of Active Matrix Liquid Crystal Displays (AMLCDs).
Philips acquired a 50 per cent stake in LGE's LCD business for EUR 1.7 billion and accounts for the investment using the equity method. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. The excess of the Company's investment over its underlying equity in the recognized net assets, commonly referred to as goodwill under Dutch GAAP, is EUR 1.3 billion. Goodwill and other intangibles are being amortized over their estimated useful lives, which average 15 years.

VLSI Technology, Inc.

In June 1999 the Company acquired all of the outstanding shares of VLSI Technology (VLSI), a semiconductor business, at a cost of EUR 1.1 billion, which included EUR 0.1 billion of assumed debt. The results of operations for VLSI have been included in the Company's consolidated financial statements from the date of acquisition. The cost of the acquisition was allocated on the basis of the fair value of the assets acquired and liabilities assumed. Based upon an independent appraisal, EUR 342 million was assigned to specific intangible assets acquired, including purchased technology, in-process R&D, patents and trademarks, and the value of the existing workforce. Of this amount, EUR 48 million, representing the value of in-process R&D that had not yet reached technological feasibility and had no alternative future use, was charged to expense as of the date of acquisition. An amount of EUR 305 million, representing the excess of cost over the fair value of the net assets acquired, has been recorded as goodwill. Goodwill and other intangibles are being amortized over their useful lives, which average approximately 7 years.

Origin B.V.

In June 1999, the Company acquired an additional 10% interest in Origin at a cost of EUR 124 million. Philips then owned approximately 98% of Origin's stockholders' equity. Goodwill resulting from the acquisition totaled EUR 107 million and had a useful life of 7 years.

Conventional Passive Components

In the first quarter of 1999, Philips sold its Conventional Passive Components activities for an amount of EUR 358 million. A gain of EUR 169 million was recognized on the sale (net of taxes EUR 130 million).

2 Income from operations

Salaries and wages

	2001	2000	1999
Salaries and wages	**7,292**	7,631	6,910
Pension costs	**(430)**	(445)	(42)
Other social security and similar charges:			
- Required by law	**1,049**	1,009	958
- Voluntary	**189**	261	190
Total	**8,100**	8,456	8,016

See note 18 to the financial statements for further information on pension costs.

Employees

The average number of employees during 2001 was 205,870 (2000: 231,161, 1999: 230,016). The number of employees by category is summarized as follows:

	2001			2000	1999
	beginning of year*	end of year	average**	average	average
Production	**128,660**	**111,401**	**124,306**	124,473	126,622
Research & Development	**23,393**	**23,394**	**23,661**	22,201	21,104
Other	**44,913**	**38,865**	**39,345**	60,484	62,443
Permanent employees	**196,966**	**173,660**	**187,312**	207,158	210,169
Temporary employees	**22,458**	**14,983**	**18,558**	24,003	19,847
Total	**219,424**	**188,643**	**205,870**	231,161	230,016

* including changes in consolidation at January 1, 2001
** (de)consolidation changes have not been taken into consideration in determining the average number of employees

The number of employees at year-end 2001 decreased by 30,781 as compared to the beginning of the year. This includes a decrease of 23,251 relating to the deconsolidation of the Display Components activities and an increase of 9,970 relating to the acquisitions of the medical systems businesses of Marconi and Agilent.

Remuneration of the Board of Management and Supervisory Board

Board of Management

Remuneration and pension costs relating to the members of the Board of Management amounted to EUR 3,043,533 (2000: EUR 4,442,733, 1999: EUR 9,412,000). The costs for former members of the Board of Management, which relate to pension charges, amounted to EUR 1,647,000 (2000: EUR 1,350,000, 1999: EUR 1,470,000).

In 2001, the present members of the Board of Management were granted 360,000 stock option rights (2000: 500,000 stock option rights, 1999: 440,000 stock option rights). At year-end 2001, the members of the Board of Management held 1,564,000 stock option rights (year-end 2000: 1,911,200) at a weighted average exercise price of EUR 24.20 (year-end 2000: EUR 20.56).

See note 25 to the financial statements for further information on stock options and pages 106 and 107 for further information on individual remuneration and interests in stock options and Philips shares.

Supervisory Board

The remuneration of the members of the Supervisory Board amounted to EUR 331,260 (2000: EUR 376,637, 1999: EUR 414,000); former members received no remuneration. The annual remuneration for individual members is EUR 40,840 and for the Chairman EUR 74,874. Additionally, the membership of committees of the Supervisory Board is compensated by an amount of EUR 4,538 per year per committee. At year-end 2001 the present members of the Supervisory Board held no stock options.

For further information on individual remuneration and interests in Philips shares, see page 108.

Depreciation and amortization

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

	2001	2000	1999
Depreciation of property, plant and equipment	**1,994**	1,808	1,565
Amortization of software	**146**	86	24
Amortization of goodwill and other intangibles:			
- Amortization of goodwill relating to consolidated companies	**216**	173	95
- Amortization of other intangible assets	**155**	125	52
Write-off of in-process R&D	**106**	44	68
	2,617	2,236	1,804

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

Included in the table above is an amount of EUR 240 million (2000: EUR 47 million, 1999: EUR 76 million) which is reported under restructuring and impairment charges.

Depreciation of property, plant and equipment includes an additional write-off in connection with the retirement of property, plant and equipment amounting to EUR 25 million in 2001 (2000: EUR 19 million, 1999: EUR 17 million).

Amortization of goodwill relating to consolidated companies and other intangible assets increased because of new acquisitions in 2001, mainly the medical systems businesses of Marconi and Agilent, and full-year amortization relating to the acquisitions in the previous year.

Research and development expenses

Expenditures for research and development activities amounted to EUR 3,312 million, representing 10.2% of sales (2000: EUR 2,766 million, 7.3% of sales; 1999: EUR 2,284 million, 7.3% of sales). The major increase in 2001 compared to last year was caused by the higher level of research and development activities and also included the effect of consolidation changes for an amount of more than EUR 200 million.

Write-off of acquired in-process Research and Development

The write-off of acquired in-process R&D in 2001 related to the acquisitions of the medical systems businesses of Agilent and Marconi (EUR 106 million); in 2000 it related to the acquisition of ADAC (EUR 44 million) and in 1999 to the acquisitions of VLSI, Voice Control Systems and Micrion/FEI (EUR 68 million).

Advertising and promotional cost

Advertising and promotional cost incurred during 2001 totaled EUR 988 million (2000: EUR 1,039 million, 1999: EUR 978 million).

Restructuring and impairment charges

The following table presents the changes in the restructuring provision from December 31, 1998 to December 31, 2001:

	balance December 31, 2000	additions	utilized	releases	other changes	balance December 31, 2001
Personnel costs	67	437	(166)	(12)		326
Write-down of assets	22	547	(560)	(3)		6
Other costs	11	136	(66)	(12)	41	110
Total	**100**	**1,120**	**(792)**	**(27)**	41	**442**

	balance December 31, 1999	additions	utilized	releases	other changes	balance December 31, 2000
Personnel costs	84	125	(115)	(27)		67
Write-down of assets	13	57	(38)	(10)		22
Other costs	18	26	(24)	(9)		11
Total	115	208	(177)	(46)		100

A goodwill-related impairment loss of EUR 35 million in the year 2000 with respect to Voice Control Systems within the sector Consumer Electronics was included in restructuring and impairment charges.

	balance December 31, 1998	additions	utilized	releases	other changes	balance December 31, 1999
Personnel costs	175	71	(116)	(46)		84
Write-down of assets	30	81	(87)	(11)		13
Other costs	60	12	(33)	(21)		18
Total	265	164	(236)	(78)		115

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

	balance December 31, 2000	additions	utilized	releases	other changes*	balance Dec. 31, 2001
Lighting	25	26	(27)	(8)		16
Consumer Electronics	5	504	(371)	(1)		137
DAP	6	4	(9)			1
Components	51	167	(140)	(11)	(6)	61
Semiconductors		204	(163)			41
Medical Systems		79	(6)	(4)	47	116
Miscellaneous	8	99	(37)	(3)		67
Unallocated	5	37	(39)			3
Total	**100**	**1,120**	**(792)**	**(27)**	41	**442**

* relate to transferred provision into the joint venture LG.Philips Displays and restructuring recorded in conjunction with the acquisition of Marconi.

Additions of EUR 1,120 million are presented by sector as follows:

	personnel costs	write-down of fixed assets	write-down of inventories	other costs	total
Lighting	20		2	4	26
Consumer Electronics	147	74	233	50	504
DAP	2			2	4
Components	51	53	35	28	167
Semiconductors	53	91	37	23	204
Medical Systems	70			9	79
Miscellaneous	71	8		20	99
Unallocated	23	14			37
Total	437	240	307	136	1,120

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

	balance December 31, 1999	additions	utilized	releases	other changes	balance December 31, 2000
Lighting	43	31	(35)	(14)		25
Consumer Electronics	21	27	(33)	(10)		5
DAP		13	(7)			6
Components	3	90	(30)	(12)		51
Semiconductors	6		(4)	(2)		
Miscellaneous	20	38	(42)	(8)		8
Unallocated	22	9	(26)			5
Total	115	208	(177)	(46)		100

Additions of EUR 208 million are presented by sector as follows:

	personnel costs	write-down of fixed assets	write-down of inventories	other costs	total
Lighting	27			4	31
Consumer Electronics	18	3		6	27
DAP	7	1	1	4	13
Components	53	17	8	12	90
Miscellaneous	17	21			38
Unallocated	3	5	1		9
Total	125	47	10	26	208

The movements in the provision for restructuring costs in 1999 are presented by sector as follows:

	balance December 31, 1998	additions	utilized	releases	other changes	balance December 31, 1999
Lighting	45	44	(31)	(15)		43
Consumer Electronics	135	6	(79)	(41)		21
DAP	8		(8)			
Components	19	79	(82)	(13)		3
Semiconductors	21		(13)	(2)		6
Miscellaneous	35	13	(21)	(7)		20
Unallocated	2	22	(2)			22
Total	265	164	(236)	(78)		115

Additions of EUR 164 million are presented by sector as follows:

	personnel costs	write-down of fixed assets	write-down of inventories	other costs	total
Lighting	34	6		4	44
Consumer Electronics	2	2	1	1	6
DAP					
Components	6	68	3	2	79
Miscellaneous	7		1	5	13
Unallocated	22				22
Total	71	76	5	12	164

The projects initiated in 2001 will ultimately reduce direct labor by approximately 7,000 persons and indirect labor by approximately 3,800 persons.

The release of surplus in 2001 was primarily attributable to reduced severance due to a transfer of employees, who were scheduled to be laid off, to other positions in the Company. The release in 2000 and 1999 also related to a change in severance as well as lower expenditures than originally planned.

The remaining prior-year provisions available at December 31, 2001 relate primarily to personnel costs. The Company expects to make cash expenditures of EUR 442 million in 2002 under existing restructuring programs.

Other business income, net

Other business income consists of amounts not directly related to the production and sale of products and services and acquisition-related costs. An amount of EUR 287 million relates to the net gain from the disposal of certain business interests (2000: EUR 1,429 million, 1999: EUR 257 million). In 2001, EUR 185 million arose from the sale of a portion of Philips' share in FEI Company. In 2000, the gain primarily related to the Atos Origin merger (EUR 1,072 million) and the sale of AC&M (EUR 309 million); in 1999 it mainly related to the sale of Conventional Passive Components (EUR 169 million).
Other business income also includes gains of EUR 74 million from the sale of fixed assets (2000: EUR 48 million), of which EUR 44 million relates to sale and lease-back transactions. In addition, EUR 80 million was received as insurance recoveries.

3 Financial income and expenses

	2001	2000	1999
Interest income	66	99	133
Interest expense	(457)	(266)	(262)
Total interest expense, net	(391)	(167)	(129)
Income from securities	5	2,217	117
Income from non-current financial assets	62	13	44
Write-off of non-current financial assets	(526)	–	–
Foreign exchange hedging costs	(64)	(86)	7
Miscellaneous financing costs	(1)	11	(7)
Total	(915)	1,988	32

In 2001, no securities were sold. Income from securities in 2000 includes the gain on the sale of JDS Uniphase shares of EUR 1,207 million. Additionally, 2000 includes the gain on the exchange of Seagram shares for Vivendi Universal shares, amounting to EUR 966 million, net of a USD hedge result. The corresponding results for 1999 include the gain on the sale of JDS Uniphase shares.

Write-off of non-current financial assets in 2001 arises from the impairments of Vivendi Universal and GN Great Nordic shares for an amount of EUR 440 million and EUR 86 million respectively (see note 12).

Dividends received in 2001 on shares of Vivendi Universal of EUR 33 million and in 1999 on Seagram shares of EUR 28 million are classified under income from non-current financial assets. In 2000, dividends received from Seagram of EUR 32 million are classified under income from securities.

4 Income taxes

The tax benefit on income from continuing operations amounted to EUR 421 million in 2001 (2000: tax expense EUR 570 million, 1999: tax expense EUR 336 million).

The components of income before taxes are as follows:

	2001	2000	1999
Netherlands	(638)	4,620	479
Foreign	(1,648)	1,649	1,304
Income before taxes	(2,286)	6,269	1,783
The components of income tax expense are as follows:			
Netherlands:			
Current taxes	(61)	120	45
Deferred taxes	(129)	277	35
	(190)	397	80
Foreign:			
Current taxes	292	349	229
Deferred taxes	(523)	(176)	27
	(231)	173	256
Income tax (benefit) expense from continuing operations	(421)	570	336

Philips' operations are subject to income taxes in various foreign jurisdictions with statutory income tax rates varying from 16% to 42%, which causes a difference between the weighted average statutory income tax rate and the Netherlands' statutory income tax rate of 35%.

A reconciliation of the weighted average statutory income tax rate as a percentage of income before taxes and the effective income tax rate is as follows:

	2001	2000	1999
Weighted average statutory income tax rate	**31.7**	34.2	33.3
Tax effect of:			
Utilization of previously unrecognized loss carryforwards	**3.9**	(2.5)	(10.6)
New loss carryforwards not recognized	**(4.8)**	1.4	5.0
Changes in the valuation of other deferred taxes	**(1.2)**	(0.3)	5.4
Released valuation allowance	**–**	(2.6)	(9.4)
Exempt income and non-deductible expenses	**(7.6)**	(19.2)	(4.0)
Withholding and other taxes	**(2.9)**	1.3	3.9
Tax incentives and other	**(0.7)**	(3.2)	(4.8)
Effective tax rate	**18.4**	9.1	18.8

In 2001 and 2000 there were no taxes on extraordinary items, compared to a EUR 2 million benefit in 1999.

The tax effects of transactions recorded directly to stockholders' equity are also recognized in stockholders' equity. The amounts recorded in 2001 include a benefit arising from stock option transactions of EUR 1 million (2000: EUR 11 million; 1999: EUR 23 million) and a charge relating to the deferred results on hedge transactions of EUR 16 million (2000: EUR 85 million, 1999: benefit of EUR 102 million). In 2000, a benefit of EUR 107 million was also included with respect to the accounting change related to inventories.

Deferred tax assets and liabilities

Deferred tax assets and deferred tax liabilities are as follows:

	2001		2000	
	assets	liabilities	assets	liabilities
Intangible fixed assets	**70**	**(470)**	80	(400)
Property, plant and equipment	**240**	**(150)**	240	(310)
Inventories	**220**	**(40)**	240	(40)
Receivables	**70**	**(10)**	80	(20)
Provisions:				
- Pensions	**100**	**(140)**	100	(110)
- Restructuring	**150**	**–**	50	–
- Guarantees	**10**	**–**	10	–
- Other	**600**	**(10)**	510	(10)
Other assets	**220**	**(430)**	40	(440)
Other liabilities	**220**	**(324)**	120	(63)
Total deferred tax assets/liabilities	**1,900**	**(1,574)**	1,470	(1,393)
Net deferred tax position	**326**		77	
Tax loss carryforwards (including tax credit carryforwards)	**1,977**		1,379	
Valuation allowances	**(1,308)**		(1,015)	
Net deferred tax assets	**995**		441	

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income in the countries where the net operating losses were incurred. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowance at December 31, 2001.
The valuation allowance for deferred tax assets as of December 31, 2001 and 2000 was EUR 1,308 million and EUR 1,015 million respectively. The net change in the total valuation allowance for the years ended December 31, 2001 and 2000 was an increase of EUR 293 million and a decrease of EUR 448 million respectively.

The portion of the valuation allowance relating to deferred tax assets, for which subsequently recognized tax benefits will be allocated to reduce goodwill or other non-current intangible assets of an acquired entity or directly to contributed capital, amounts to EUR 52 million (2000: EUR 50 million).

At December 31, 2001, operating loss carryforwards expire as follows:

Total	2002	2003	2004	2005	2006	2007/2011	later	unlimited
4,810	40	100	100	40	60	450	670	3,350

The Company also has tax credit carryforwards of EUR 479 million, which are available to offset future tax, if any, and which expire as follows:

Total	2002	2003	2004	2005	2006	2007/2011	later	unlimited
479	27	6	5	6	5	8	19	403

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

	2001	2000
Deferred tax assets grouped under non-current receivables	1,482	916
Deferred tax liabilities grouped under provisions	(487)	(475)
	995	441

An amount of EUR 516 million (2000: EUR 441 million), included in deferred tax assets of EUR 1,482 million, is expected to be realized within one year.

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

	2001	2000
Income tax receivable grouped under non-current receivables	95	89
Income tax receivable grouped under current receivables	42	24
Income tax payable grouped under current liabilities	(328)	(613)

The amount of the unrecognized deferred income tax liability for temporary differences, EUR 145 million (2000: EUR 254 million), relates to unremitted earnings in foreign Group companies, which are considered to be permanently re-invested. Under current Dutch tax law, no additional taxes are payable. However, in certain jurisdictions, withholding taxes would be payable.

5 Results relating to unconsolidated companies

	2001	2000	1999
Results relating to unconsolidated companies:			
- income (loss) excluding amortization of goodwill and other intangibles	(387)	4,094	458
- amortization of goodwill and other intangibles	(367)	(124)	(49)
Total	(754)	3,970	409

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

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

The results for 1999 included a special item in respect of EUR 67 million TSMC dilution gain.

Amortization of goodwill and other intangibles includes the amortization of the excess of the Company's investment over its underlying equity in the net assets of unconsolidated companies of EUR 180 million in 2001 (2000: EUR 84 million, 1999: EUR 49 million) and the Company's share of amortization recorded by the unconsolidated companies of EUR 187 million in 2001 (2000: EUR 40 million, 1999: nil).

Amortization of goodwill and other intangibles in 2001 was substantially higher than the previous year because of full-year amortization of Atos Origin and six month amortization relating to LG.Philips Displays.

Investments in, and loans to, unconsolidated companies

Amortization of goodwill, changes in deferred taxes and gains on sales, totaling EUR 128 million net, are not included in 'share in income' in the table below.

The changes during 2001 are as follows:

	total	investments	loans
Balance as of January 1, 2001	5,328	4,793	535
Changes:			
Acquisitions/additions	1,227	1,108	119
Sales/redemptions	(245)	(47)	(198)
Share in income	(626)	(619)	(7)
Dividend received	(85)	(85)	–
Changes in consolidations	20	20	–
Translation and exchange rate differences	13	–	13
Balance as of December 31, 2001	**5,632**	**5,170**	**462**

The excess of the Company's investment over its underlying equity in the net assets of unconsolidated companies, commonly referred to as goodwill under Dutch GAAP, is not included in investments in unconsolidated companies but in intangible assets.

Loans to unconsolidated companies include redeemable preferred shares of TSMC for an amount of EUR 431 million (2000: EUR 421 million).
Philips' stake in NavTech has been increased from 50% to 82% and as a consequence the company is consolidated as of January 1, 2001. The majority shareholding in FEI Company was reduced to 25.5%, resulting in deconsolidation as from May 1, 2001.
The investments in unconsolidated companies at December 31, 2001 include EUR 204 million (2000: EUR 215 million) for companies accounted for under the cost method. Income from unconsolidated companies includes EUR 1 million (2000: EUR 3 million) representing dividends received.

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

	2001		2000
	shareholding %	amount	
Philips' joint ventures with LGE (Korea)	50.0	**1,182**	832
Taiwan Semiconductor Manufacturing Co. (Taiwan)	21.8	**2,450**	2,553
Atos Origin (France)	48.7	**1,388**	1,449
Other		**612**	494
Total		**5,632**	5,328

The fair values of Philips' shareholdings in TSMC and Atos Origin, based on quoted market prices at December 31, 2001, were EUR 10.4 billion (2000: EUR 6.7 billion) and EUR 1.6 billion (2000: EUR 1.6 billion) respectively.

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

	January-December		
	2001	2000	1999
Net sales	**12,697**	9,039	5,633
Income before taxes	**(911)**	2,572	1,254
Income taxes	**38**	(4)	(124)
Income after taxes	**(873)**	2,568	1,130
Net income	**(1,091)**	2,594	1,097
Total share in net income of unconsolidated companies recognized in the consolidated statements of income	**(754)**	1,333	412

	December 31,	
	2001	2000
Current assets	**7,740**	5,080
Non-current assets	**18,882**	16,609
	26,622	21,689
Current liabilities	**(6,397)**	(4,123)
Non-current liabilities	**(4,924)**	(3,427)
Net asset value	**15,301**	14,139
Investments in and loans to unconsolidated companies included in the consolidated balance sheet	**5,632**	5,328

6 Minority interests

The share of third-party minority interests in the loss of Group companies in 2001 amounted to EUR 15 million, compared with the share in income of EUR 67 million and EUR 52 million in 2000 and 1999 respectively.

Minority interests in consolidated companies, totaling EUR 202 million (2000: EUR 469 million), are based on the third-party shareholding in the underlying net assets.
The change in 2001 is mainly attributable to the deconsolidation of FEI Company and Hua Fei China in connection with the establishment of the joint venture LG.Philips Displays. Moreover, the buy-out of third-party minority shareholdings in India, Pakistan and South Africa resulted in a further reduction. The consolidation of NavTech slightly increased minority interests.

7 Extraordinary items - net

There were no extraordinary items in 2001 and 2000.
Extraordinary losses in 1999 (EUR 7 million, net of taxes EUR 5 million) resulted from the early redemption of debt.

8 Earnings per share

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

		2001		2000		1999
Weighted average number of shares		**1,278,076,537**		1,312,859,102		1,378,040,952
Basic EPS computation						
- Income (loss) from continuing operations available to holders of common shares		**(2,604)**		9,602		1,804
- Extraordinary items – net		**–**		–		(5)
Net income (loss) available to holders of common shares		**(2,604)**		9,602		1,799
Diluted EPS computation						
- Income (loss) from continuing operations available to holders of common shares		**(2,604)**		9,602		1,804
- Plus interest on assumed conversion of convertible debentures, net of taxes		**1**		1		–
- Income (loss) available to holders of common shares		**(2,603)**		9,603		1,804
- Extraordinary items – net		**–**		–		(5)
Net income (loss) available to holders of common shares plus effect of assumed conversions		**(2,603)**		9,603		1,799
Weighted average number of shares		**1,278,076,537**		1,312,859,102		1,378,040,952
Plus shares applicable to:						
- Options	**6,420,978**		9,961,410		6,954,752	
- Convertible debentures	**2,046,122**		3,717,651		4,230,552	
Dilutive potential common shares		**8,467,100**		13,679,061		11,185,304
Adjusted weighted average number of shares		**1,286,543,637**		1,326,538,163		1,389,226,256
Earnings per share:						
- Basic earnings		**(2.04)**		7.31		1.31
- Diluted earnings *		**(2.04)**		7.24		1.30

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

9 Securities

Included in securities are investments in equity securities which have been designated as available for sale (immediately available or within a period of one year) relating to shares of JDS Uniphase and ASML.
All are carried at the lower of cost or market value and are presented in the table below:

	2001			2000
	number of shares	book value	market value	book value
JDS Uniphase	10,477,168	77	103	61
ASML	30,000,000	50	586	50
Others		3	3	–
Balance as of December 31		**130**	**692**	111

During 2001 no changes in securities have taken place with regard to the number of shares in JDS Uniphase and ASML.

During 2000 a portion of the JDS Uniphase shares was sold (see note 3).

In December 2000, Philips exchanged its Seagram shares for Vivendi Universal shares, which have been classified under other non-current financial assets (see note 12).

10 Receivables

Trade accounts receivable include installment accounts receivable of EUR 69 million (2000: EUR 69 million).

Discounted drafts of EUR 5 million (2000: EUR 8 million) have been deducted.

Income taxes receivable (current portion) totaling EUR 42 million (2000: EUR 24 million) are included under other receivables.

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

	2001	2000	1999
Balance as of January 1,	**181**	278	186
Additions charged to income	**43**	59	198
Deductions from allowance *	**(37)**	(182)	(118)
Other movements **	**94**	26	12
Balance as of December 31,	**281**	181	278

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

11 Inventories

Inventories are summarized as follows:

	2001	2000
Raw materials and supplies	**1,507**	1,638
Work in process	**762**	1,125
Finished goods	**2,187**	2,627
Advance payments on work in process	**(166)**	(111)
Total	**4,290**	5,279

The decrease in inventories in 2001 compared to 2000 is predominantly caused by supply chain improvements and programs. Lower inventories in Components, as a result of the deconsolidation of Philips' CRT business were offset by additional inventories from acquisitions in Medical Systems.

The changes in the reserve for obsolescence of inventories are as follows:

	2001	2000	1999
Balance as of January 1,	754	630	735
Additions charged to income	397	302	242
Deductions from reserve	(351)	(243)	(392)
Other movements *	109	65	45
Balance as of December 31,	**909**	754	630

* Including the effect of translation differences and consolidation changes

12 Other non-current financial assets

The changes during 2001 are as follows:

	total	security investments	loans	restricted liquid assets
Balance as of January 1, 2001	3,747	3,511	93	143
Changes:				
Acquisitions/additions	104	1	65	38
Sales/redemptions	(550)	(465)	(80)	(5)
Value adjustments	(527)	(526)	(1)	–
Translation and exchange differences	(2)	–	(2)	–
Changes in consolidation	17	(3)	20	–
Balance as of December 31, 2001	**2,789**	**2,518**	**95**	**176**
Accumulated total of write-downs included in the book value	543	530	13	–

The sale of security investments in 2001 primarily consists of the redemption of the convertible redeemable preferred shares of LG Electronics of Korea (see note 1). Included in security investments are 38,265,561 shares in Vivendi Universal, a strategic investment being held in order to strengthen the Company's opportunities for a long-term relationship. Security investments also includes 6,830,687 shares in GN Great Nordic received in 2000 in exchange for the Company's equity position in Beltone Electronics Inc. Philips is restricted from selling these shares until 2003, a period of three years from the acquisition date.

In view of the extended period of time over which the market value of the security investments in Vivendi Universal and GN Great Nordic was below bookvalue, these shares were written down to fair value at December 31, 2001, being EUR 2,353 million and EUR 46 million respectively. The impairment losses of EUR 440 million and EUR 86 million respectively are included in financial income and expenses.

Other security investments include EUR 115 million of shares that are not available for sale or redemption (2000: EUR 111 million).

13 Non-current receivables

Non-current receivables include receivables with a remaining term of more than one year, and the non-current portion of income taxes receivable amounting to EUR 95 million (2000: EUR 89 million). Prepaid expenses in 2001 include prepaid pension costs of EUR 1,740 million (2000: EUR 1,469 million) and deferred tax assets of EUR 1,482 million (2000: EUR 916 million).

14 Property, plant and equipment

The components of property, plant and equipment and the changes during 2001 were as follows:

Property, plant and equipment

	total	land and buildings	machinery and installations	other equipment	prepayments and construction in progress	no longer productively employed
Balance as of January 1, 2001:						
Cost	20,265	3,821	11,804	2,840	1,741	59
Accumulated depreciation	(11,224)	(1,733)	(7,370)	(2,066)	–	(55)
Book value	9,041	2,088	4,434	774	1,741	4
Changes in book value:						
Capital expenditures	2,143	325	1,603	476	(267)	6
Retirements and sales	(208)	(38)	(100)	(26)	(37)	(7)
Depreciation	(1,948)	(154)	(1,355)	(436)	(1)	(2)
Write-downs and impairments	(21)	(5)	(6)	(10)		
Translation differences	231	43	129	17	42	–
Changes in consolidation	(1,520)	(235)	(844)	(15)	(430)	4
Total changes	(1,323)	(64)	(573)	6	(693)	1
Balance as of December 31, 2001:						
Cost	18,069	3,732	10,456	2,796	1,048	37
Accumulated depreciation	(10,351)	(1,708)	(6,595)	(2,016)	–	(32)
Book value	**7,718**	**2,024**	**3,861**	**780**	**1,048**	**5**

Land is not depreciated.

The expected service lives as of December 31, 2001 were as follows:

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

15 Intangible assets

The changes during 2001 were as follows:

	total	goodwill relating to consolidated companies	goodwill relating to unconsolidated companies*	other intangibles	software
Balance as of January 1, 2001:					
Acquisition cost	5,219	2,295	1,294	1,262	368
Accumulated amortization	(792)	(289)	(132)	(257)	(114)
Book value	4,427	2,006	1,162	1,005	254
Changes in book value:					
Acquisitions	3,555	1,744	801	776	234
Amortization and write-downs	(803)	(216)	(180)	(261)	(146)
Translation differences	87	37	1	45	4
Changes in consolidation	3	(50)	–	(15)	68
Total changes	2,842	1,515	622	545	160
Balance as of December 31, 2001:					
Acquisition cost	8,658	3,978	2,095	1,909	676
Accumulated amortization	(1,389)	(457)	(311)	(359)	(262)
Book value	**7,269**	**3,521**	**1,784**	**1,550**	**414**

* Represents the excess of the Company's investment over its underlying equity in the net assets of the unconsolidated companies

Goodwill relating to consolidated companies of EUR 1,744 million arose from the acquisitions of medical systems businesses of Agilent and Marconi as well as several smaller items. Goodwill relating to unconsolidated companies arose from the formation of the display joint venture with LG Electronics (see note 1).

The amount of other intangibles acquired (EUR 776 million) includes the amounts paid for in-process R&D of EUR 106 million relating to the aforementioned acquisitions of medical systems businesses which amount was charged directly to the 2001 income statement. In-process R&D for 2000 amounted to EUR 44 million (1999: EUR 68 million). Additionally, acquisitions include other specific intangible assets acquired in the above-mentioned transactions, such as purchased technology, patents and trademarks, the value of the customer base and, up to June 30, 2001, the value of the assembled workforce (see note 1). The value of the acquired assembled workforces of the medical systems businesses of Agilent and Marconi have been subsumed into goodwill in accordance with SFAS No. 141, 'Business Combinations'.

Amortization of goodwill relating to unconsolidated companies totaling EUR 180 million (2000: EUR 84 million, 1999: EUR 49 million) was not included in income from operations but was charged to results relating to unconsolidated companies (see note 5).

The amortization periods as of December 31, 2001 are as follows:

Goodwill	from 5 to 15 years
Other intangibles	from 3 to 15 years
Software	average 3 years

16 Accrued liabilities

Accrued liabilities are summarized as follows:

	2001	2000
Personnel-related costs:		
- Salaries and wages payable	**493**	546
- Accrued holiday rights	**215**	232
- Accrued pension costs	**52**	38
- Other	**90**	66
Taxes:		
- Income tax payable	**328**	613
- Other taxes payable	**30**	33
Commission, freight, interest and rent payable	**513**	389
Deferred income	**291**	367
Advertising costs payable	**110**	126
IT costs payable	**47**	35
Warranties	**30**	19
Other liabilities	**1,938**	1,237
Total	**4,137**	3,701

17 Provisions

Provisions are summarized as follows:

	2001		2000	
	Long-term	Short-term	Long-term	Short-term
Pensions (see note 18):				
- Defined-benefit plans	**699**	**100**	900	68
- Other postretirement benefits	**417**	**56**	385	47
Post-employment benefits	**85**	**26**	79	17
Deferred tax liabilities (see note 4)	**405**	**82**	282	193
Restructuring (see note 2)	**58**	**384**	20	80
Obligatory severance payments	**100**	**55**	129	57
Replacement and guarantees	**83**	**359**	74	354
Other provisions	**437**	**394**	653	153
Total	**2,284**	**1,456**	2,522	969

Obligatory severance payments

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

Replacement and guarantees

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

Other provisions

Other provisions include provisions for expected losses on existing projects/orders totaling EUR 32 million (2000: EUR 38 million), for employee jubilee funds totaling EUR 107 million (2000: EUR 115 million) and environmental provisions of EUR 238 million (2000: EUR 202 million).

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

Balance as of January 1, 2001	1,516
Changes:	
Additions	667
Utilization	(644)
Balance as of December 31, 2001	**1,539**

18 Pensions and postretirement benefits other than pensions

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

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

Contributions are made by the Company, as necessary, to provide assets sufficient to meet the benefits payable to defined-benefit pension plan participants. These contributions are determined based upon various factors, including legal and tax considerations as well as local customs. The Company funds certain defined-benefit pension plans and other postretirement benefit plans as claims are incurred. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for defined-benefit pension plans with accumulated benefit obligations in excess of plan assets were EUR 208 million, EUR 199 million and EUR 170 million respectively as of December 31, 2001 (2000: EUR 138 million, EUR 120 million and EUR 85 million respectively).

Provided below is a table with a summary of the changes in the pension benefit obligations and defined pension plan assets for 2001 and 2000, and a reconciliation of the funded status of these plans to the amounts recognized in the consolidated balance sheets.

Also provided below is a table with a summary of the changes in the accumulated postretirement benefit obligations and plan assets for 2001 and 2000, and a reconciliation of the obligations to the amounts recognized in the consolidated balance sheets.

	2001	2000	2001	2000
		pension benefits		postretirement benefits
Benefit obligation				
Benefit obligation at beginning of year	**18,523**	17,731	**632**	580
Service cost	**351**	366	**12**	13
Interest cost	**1,105**	1,090	**43**	43
Employee contributions	**28**	32	**–**	–
Actuarial (gains) and losses	**(51)**	401	**34**	13
Plan amendments	**6**	73	**–**	2
Settlements	**(8)**	(191)	**–**	–
Curtailments	**–**	(9)	**–**	(7)
Changes in consolidations	**3**	(204)	**(29)**	8
Benefits paid	**(1,015)**	(940)	**(47)**	(47)
Exchange rate differences	**125**	156	**14**	24
Miscellaneous	**(3)**	18	**(2)**	3
Benefit obligation at end of year	**19,064**	18,523	**657**	632
Plan assets				
Fair value of plan assets at beginning of year	**22,505**	23,799	**17**	14
Actual return on plan assets	**(996)**	(130)	**1**	2
Employee (refunds) contributions	**28**	32	**–**	–
Employer contributions	**(205)**	(215)	**2**	3
Settlements	**(11)**	(125)	**–**	–
Curtailments	**–**	(2)	**–**	–
Changes in consolidations	**54**	(235)	**(15)**	4
Benefits paid	**(923)**	(855)	**(3)**	(6)
Exchange rate differences	**143**	228	**(2)**	–
Miscellaneous	**(1)**	8	**–**	–
Fair value of plan assets at end of year	**20,594**	22,505	**–**	17
Funded status	**1,530**	3,982	**(657)**	(615)
Unrecognized net transition (asset) obligation	**(82)**	(140)	**122**	136
Unrecognized prior service cost	**161**	192	**6**	7
Unrecognized net (gain) loss	**(701)**	(3,571)	**56**	40
Net balances	**908**	463	**(473)**	(432)

	2001	2000
Classification of the net balances is as follows:		
- Prepaid pension costs under non-current receivables	**1,740**	1,469
- Accrued pension costs under accrued liabilities	**(52)**	(38)
- Provisions for pensions under provisions	**(799)**	(968)
- Intangible assets	**1**	–
- Stockholders' equity	**18**	–
	908	463

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

	2001	2000
Discount rate	6.1%	6.0%
Rate of compensation increase	3.4%	3.4%
Expected return on plan assets	7.2%	7.0%

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

	2001	2000	1999
Service cost – benefits earned during the period	351	366	424
Interest cost on the projected benefit obligation	1,105	1,090	977
Expected return on plan assets	(1,625)	(1,535)	(1,353)
Net amortization of unrecognized net transition assets	(68)	(98)	(100)
Net actuarial gain recognized	(284)	(231)	(13)
Amortization of prior service cost	31	21	14
Settlement (gain) loss	4	(106)	8
Curtailment (gain) loss	1	1	–
Minimum pension liability (gain) loss	–	(23)	(29)
Net periodic pension cost	(485)	(515)	(72)

The Company also sponsors defined-contribution and similar-type plans for a significant number of salaried employees. The total cost of these plans amounted to EUR 55 million in 2001 (2000: EUR 70 million, 1999: EUR 30 million).

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

	2001	2000	1999
Service cost-benefits earned during the period	12	13	13
Interest cost on accumulated postretirement benefit obligation	43	43	35
Expected return on plan assets	(1)	(2)	(2)
Amortization of unrecognized transition obligation	11	13	13
Net actuarial loss recognized	1	1	2
Curtailment loss	–	22	9
Settlement gain	–	–	(5)
Net periodic cost	66	90	65

The accumulated postretirement benefit obligation was determined using a weighted average discount rate of 7.0% (2000: 7.0%), an assumed compensation increase, where applicable, of 4.6% (2000: 4.6%), and an expected return on plan assets, where applicable, of 11.7% (2000: 11.7%). For measurement purposes, the rate of increase in per capita healthcare costs is assumed to be on average 5.7% for 2001, reaching 5% by the year 2005. Healthcare cost trend assumptions have a significant effect on the amounts reported for other postretirement benefits. Increasing the assumed healthcare cost trend rate by 1 percentage point would increase the accumulated postretirement benefit obligation as of December 31, 2001 by approximately EUR 62 million and increase the net periodic postretirement benefit cost for 2001 by EUR 5 million. Conversely, decreasing the assumed healthcare cost trend by 1 percentage point would decrease the accumulated postretirement benefit obligation as of December 31, 2001 by approximately EUR 51 million and decrease the net periodic postretirement benefit cost for 2001 by EUR 6 million.

19 Other current liabilities

Other current liabilities are summarized as follows:

	2001	2000
Advances received from customers on orders not covered by work in process	192	168
Other taxes including social security premiums payable	381	375
Other short-term liabilities	240	319
Total	813	862

20 Short-term debt

	2001	2000
Short-term bank borrowings	552	1,140
Commercial paper	521	–
Other short-term loans	18	130
Current portion of long-term debt	180	473
Total	1,271	1,743

During 2001 the weighted average interest rate on the bank borrowings was 5.5% (2000: 5.7% and 1999: 5.5%), and on commercial paper 3.9% (in 2001 only, due to newly established global commercial paper program).

21 Long-term debt

	range of interest rates	average rate of interest	amount outstanding	due in 2002	due after 2002	due after 2006	average remaining term (in years)
Convertible debentures	1.6	1.6	134	–	134	–	3.5
Other debentures	5.0-8.8	6.1	6,253	147	6,106	3,060	5.3
Private financing	2.5-5.8	3.7	2	–	2	–	3.5
Bank borrowings	1.3-14.5	6.2	200	8	192	94	4.8
Liabilities arising from finance lease transactions	2.9-5.5	4.6	15	6	9	–	3.0
Other long-term debt	4.9-7.2	5.8	171	19	152	43	3.9
Total		6.0	6,775	180	6,595	3,197	
Corresponding data previous year		7.0	2,757	473	2,284	1,063	

The following amounts of long-term debt as of December 31, 2001 are due in the next five years:

2002	180
2003	306
2004	2,399
2005	313
2006	380
	3,578
Corresponding amount previous year	1,694

Of the total long-term debt outstanding, a portion amounting to EUR 180 million which falls due in 2002, is included in short-term debt.

In the Netherlands, Philips issues personnel debentures with a 5-year right of conversion into common shares of Royal Philips Electronics. Personnel debentures which were issued after December 31, 1998 may not be converted within a period of 3 years after the date of issue. These personnel debentures are available to most employees and are purchased by them with their own funds. The personnel debentures are redeemable on demand, but in practice are considered to be a form of long-term financing. The personnel debentures become non-convertible debentures at the end of the conversion period. At such time, they will be reported as other long-term debt.
At December 31, 2001 an amount of EUR 134 million (2000: EUR 105 million) of personnel debentures was outstanding, with an average conversion price of EUR 26.27 and an average interest rate of 1.6%. The conversion price varies between EUR 12.08 and EUR 49.50, with various conversion periods ending between January 1, 2002 and December 31, 2006.

During 2001, Philips issued new bonds for a total amount of EUR 4,250 million, as follows:

In May 2001, two tranches consisting of:
- EUR 1,500 million with a fixed coupon of 5.75%, maturing in 2008;
- EUR 750 million with a fixed coupon of 6.125%, maturing in 2011.

In July 2001, two tranches consisting of:
- EUR 1,000 million with a fixed coupon of 5.125%, maturing in 2004;
- EUR 1,000 million with a floating coupon of EURIBOR + 0.625%, maturing in 2004.

Two outstanding bonds matured during 2001 for a total amount of EUR 441 million.

Philips had two ‘putable’ US dollar bonds outstanding at year-end 2001, which amount to EUR 304 million (2000: EUR 288 million), for which the investor may require prepayment in one specific month during the lifetime of the respective bond. The average remaining tenor of total outstanding long-term debt was 5.2 years, compared to 5.9 years in 2000, assuming that investors require payment at the relevant put dates. However, assuming that the ‘putable’ bonds will be repaid at final maturity dates, the average remaining tenor at the end of 2001 was 6.1 years, compared to 8.4 years at the end of 2000.

At the end of 2001, the Group had long-term committed and undrawn credit lines available of USD 2.5 billion (2000: USD 2.5 billion). The commitment fees amounted to EUR 2 million.

22 Secured liabilities

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

	amount of the debt	collateral	
		tangible fixed assets	other assets
Institutional financing	21	37	88
Other debts	16	28	2
Total	**37**	**65**	**90**
Previous year	45	78	107

23 Commitments and contingent liabilities

Long-term operating lease commitments totaled EUR 768 million in 2001 (2000: EUR 614 million). These leases expire at various dates during the next 20 years. The payments which fall due in connection with these obligations during the coming five years are:

2002	136
2003	120
2004	113
2005	77
2006	101

Guarantees given with regard to unconsolidated companies and third parties amounted to EUR 792 million (2000: EUR 805 million). The amount of conditional liabilities was EUR 8 million (2000: EUR 9 million).

Royal Philips Electronics and certain of its Group companies are involved as plaintiff or defendant in litigation relating to such matters as competition issues, commercial transactions, product liability, participations and environmental pollution. On the basis of information received to date, the Board of Management believes that this litigation will not materially affect Royal Philips Electronics' financial position and results of operations.

During 1999 the Company entered into agreements for the construction of the first phase of the High Tech Campus in the Netherlands. Upon completion of the first phase, the buildings will be leased to Philips until 2007. Commitments have been entered into, and a guarantee has been issued, for all present and future monetary payment obligations of the lessee, Philips Electronics Nederland B.V., with a maximum amount of EUR 130 million. The actual contingent liability outstanding at year-end from this guarantee is EUR 99 million (2000: EUR 26 million), which is the amount spent so far. The first lease payments were due in 2001, when the first premises became available for use.

The Company entered into two sale and operational lease-back arrangements where it sold office buildings for an aggregate amount of EUR 89 million in the Netherlands and the USA. The rental periods are 10 and 20 years, with the possibility to prolong both contracts. The rental payments are fixed but can be indexed, with a maximum of 5% per year. The rental payments for 2001 totaled EUR 0.2 million as both transactions took place in the second half of December 2001. Assuming a 5% index per year for the building in the Netherlands, the remaining minimum payments in millions of euros are as follows:

2002	8
2003	8
2004	8
2005	9
2006	9
Later	83

24 Stockholders' equity

Priority shares

There are ten priority shares.
The issuance of shares or rights to shares, cancellation of shares, amendments to the Articles of Association and the liquidation of the Company need approval of the priority shareholders, who also make a binding recommendation for the appointment of members of the Board of Management and the Supervisory Board (see also page 111).

Preference shares

The 'Stichting Preferente Aandelen Philips' has been granted the right to acquire preference shares in the Company. Such right has not been exercised (see also page 111).

Option rights

The Company has granted stock options on shares of Royal Philips Electronics at original exercise prices equal to market prices of the shares at the date of grant (see note 25).

Other reserves

Royal Philips Electronics' shares which have been repurchased and are held in treasury for delivery upon exercise of options and convertible personnel debentures are accounted for in stockholders' equity under other reserves. Treasury shares are recorded at cost, representing the market price on the acquisition date.
In order to reduce potential dilution effects, a total of 12,678,002 shares were acquired during 2001 at an average market price of EUR 29.86 per share, totaling EUR 379 million, and a total of 2,955,712 shares were delivered at an average exercise price of EUR 22.67.
A total of 41,897,949 shares were being held by Group companies at December 31, 2001 (2000: 32,175,659 shares after stock split), acquired at an aggregate cost of EUR 1,294 million.

A net deferred foreign-exchange hedge loss (net of taxes) of EUR 7 million (2000: EUR 29 million loss) is included under other reserves.

The changes are as follows:

	2001	2000
Balance as of January 1	(29)	(161)
Adjustments due to transition rules	–	58
Net change in hedging transactions	(31)	(403)
Recognition into earnings	40	577
Translation differences	(1)	(100)
Changes in consolidation	14	–
Balance as of December 31 *	(7)	(29)

* Estimated net amount expected to be reclassified into earnings within the next 12 months: EUR 7 million.

At the beginning of the year 2000 the opening balance of the deferred foreign exchange hedges was adjusted due to the introduction of SFAS No. 133. In the course of the year the deferred position was affected by substantial movements in the deferred foreign exchange results related to securities. Before the end of the year the majority of these results were recognized into earnings.

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

25 Stock-based compensation

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

In 2001, fixed stock options and performance (variable) stock options were granted under the Corporate Philips Stock Option Plan 2001.
Under this plan, options are granted for ten years, with a three-year restriction period during which no options can be exercised. The actual number of performance stock options that will be eligible for vesting will be determined based upon Total Shareholder Return of Philips, as defined in comparison with a peer group of multinationals over a three-year period.
In prior years, options were issued with terms of either five or ten years, all vesting within two or three years from grant.

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

Under the terms of an employee stock purchase plan established by the Company in the USA and various other countries, substantially all employees in those countries are eligible to purchase a limited number of shares of Philips stock, through payroll withholdings, at a price equal to the lower of 85% of the closing price at the beginning or end of quarterly stock purchase periods. A total of 955,668 shares were sold in 2001 under the plan at a price of USD 21.66 (2000: 54,034 shares, at a price of USD 36.13).

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

The Company accounts for stock-based compensation using the intrinsic value method. Accordingly, no compensation has been recorded for the fixed stock options granted, nor for the stock purchase plan. Compensation cost of EUR 5 million was recognized for the performance stock options granted based on the market value of the shares at December 31, 2001.

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

	2001	2000	1999
Net income (loss):			
- As reported	**(2,604)**	9,602	1,799
- Pro forma	**(2,690)**	9,515	1,775
Basic earnings per share:			
- As reported	**(2.04)**	7.31	1.31
- Pro forma	**(2.10)**	7.25	1.29
Diluted earnings per share:			
- As reported	**(2.04)**	7.24	1.30
- Pro forma	**(2.10)**	7.17	1.28

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

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

The fair value of the Company's 2001, 2000 and 1999 option grants was estimated using a Black-Scholes option pricing model and the following assumptions:

	2001	2000	1999
		(EUR-denominated)	
Risk-free interest rate	**4.66%**	5.06%	3.19%
Expected dividend yield	**1.2%**	0.7%	1.2%
Expected option life	**5 yrs**	4 yrs	4 yrs
Expected stock price volatility	**49%**	46%	37%

	2001	2000	1999
		(USD-denominated)	
Risk-free interest rate	**4.77%**	6.26%	5.32%
Expected dividend yield	**1.2%**	0.9%	1.2%
Expected option life	**5 yrs**	5 yrs	5 yrs
Expected stock price volatility	**49%**	43%	37%

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

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The following table summarizes information about the stock options outstanding at December 31, 2001:

Fixed option plans

	options outstanding			options exercisable	
	number outstanding at Dec. 31, 2001	exercise price per share	weighted average remaining contractual life (years)	number exercisable at Dec. 31, 2001	weighted average exercise price per share
		(price in EUR)			(price in EUR)
1997	1,664,200	9.19 – 19.43	0.3	1,664,200	12.98
1998	2,012,800	11.57 – 21.02	1.2	2,012,800	16.55
1999	3,758,400	15.76 – 23.01	2.2	–	
2000	3,397,425	42.03 – 53.75	8.3	–	
2001	5,258,660	24.35 – 37.60	9.3	–	
		(price in USD)			(price in USD)
1998	1,455,886	12.94 – 23.59	6.3	1,455,886	17.26
1999	2,296,762	22.24 – 35.34	7.3	1,442,537	23.17
2000	3,385,382	36.65 – 49.71	8.4	–	
2001	4,893,025	22.12 – 34.50	9.3	–	
	28,122,540			6,575,423	

Variable plans

	number outstanding at Dec. 31, 2001	exercise price per share	weighted average remaining contractual life (years)	number exercisable at Dec. 31, 2001	weighted average exercise price per share
		(price in EUR)			(price in EUR)
2000	3,394,025	42.03 – 53.75	8.3	–	
2001	4,862,060	24.35 – 37.60	9.2	–	
		(price in USD)			(price in USD)
1993-1994	223,610	2.75 – 6.89	1.0	223,610	2.92
1995-1997	1,260,272	7.50 – 14.20	3.0	1,260,272	7.80
2000	3,385,382	36.65 – 49.71	8.4	–	
2001	4,893,025	22.12 – 34.50	9.3	–	
	18,018,374			1,483,882	

A summary of the status of the Company's stock option plans as of December 31, 2001, 2000 and 1999 and changes during the years then ended is presented below:

Fixed option plans

	2001		2000		1999	
	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)
Outstanding at the beginning of the year	**12,305,150**	**22.75**	13,261,600	14.27	15,376,800	11.61
Granted	**5,282,385**	**31.45**	3,445,850	43.52	3,983,400	16.22
Exercised	**(1,330,000)**	**9.82**	(4,172,484)	13.56	(6,062,600)	8.47
Forfeited	**(166,050)**	**27.46**	(229,816)	11.61	(36,000)	9.19
Outstanding at the end of the year	**16,091,485**	**26.63**	12,305,150	22.75	13,261,600	14.27
Weighted average fair value of options granted during the year in EUR	**14.75**		17.42		4.76	
		(price in USD)		(price in USD)		(price in USD)
Outstanding at the beginning of the year	**7,865,003**	**31.17**	4,996,988	20.66	2,484,600	17.34
Granted	**5,243,503**	**26.97**	4,015,797	42.25	2,914,700	23.12
Exercised	**(183,325)**	**19.21**	(665,900)	19.06	(295,644)	17.52
Forfeited	**(894,126)**	**33.68**	(481,882)	32.76	(106,668)	20.47
Outstanding at the end of the year	**12,031,055**	**29.34**	7,865,003	31.17	4,996,988	20.66
Weighted average fair value of options granted during the year in USD	**11.90**		18.38		8.55	

Variable plans

	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)	shares	weighted average exercise (price in EUR)
Outstanding at the beginning of the year	**3,426,350**	**43.53**	–	–	–	–
Granted	**4,899,485**	**33.91**	3,445,850	43.52	–	–
Exercised	**–**	**–**	–	–	–	–
Forfeited	**(69,750)**	**37.55**	(19,500)	42.92	–	–
Outstanding at the end of the year	**8,256,085**	**37.87**	3,426,350	43.53	–	–
Weighted average fair value of options granted during the year in EUR	**14.75**		17.42		–	
		(price in USD)		(price in USD)		(price in USD)
Outstanding at the beginning of the year	**5,363,954**	**31.97**	2,787,200	7.14	4,804,736	6.95
Granted	**5,243,503**	**26.97**	4,015,797	42.25	–	–
Exercised	**(72,262)**	**6.54**	(1,174,348)	7.28	(1,904,648)	6.62
Forfeited	**(772,906)**	**35.31**	(264,695)	36.09	(112,888)	7.99
Outstanding at the end of the year	**9,762,289**	**29.21**	5,363,954	31.97	2,787,200	7.14
Weighted average fair value of options granted during the year in USD	**11.90**		18.38		–	

26 Financial instruments and risks

Currency fluctuations may impact Philips' financial results. Furthermore, Philips is exposed to interest rate risk, commodity price risk, equity price risk and credit risk. The Company does not purchase or hold derivative financial instruments for trading purposes.

Currency risk

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

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

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

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

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

Philips does not currently hedge the foreign exchange exposure arising from securities available for sale. Forward foreign exchange hedges that were outstanding at the end of 2000 became ineffective, and the results have been charged to financial income and expenses for an amount of EUR 35 million.

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

An instantaneous 10% strengthening or weakening of non-euro currencies against the euro from their levels at December 31, 2001, with all other variables held constant, would result in an estimated change in the fair value of the Company's financial instruments of EUR 43 million, compared with EUR 18 million in 2000. For the purpose of this analysis, financial instruments consist of debt, liquid assets, securities and derivative financial instruments, leading to the following sensitivity:

	Sensitivity to a 10% increase in the euro versus non-euro currencies
Debt	(589)
Liquid assets	(2)
Securities	(10)
Derivatives	644
Total	43

The US dollar and the pound sterling account for a significant percentage of the above exposure. An instantaneous 10% increase of the US dollar against the euro from their levels at December 31, 2001, with all other variables held constant, and an instantaneous 10% increase of the pound sterling against the euro from their levels at December 31, 2001, with all other variables held constant, would result in the following changes in the fair value of the Company's financial derivatives.

	Sensitivity to a 10% increase in the euro versus the US dollar	Sensitivity to a 10% increase in the euro versus the pound sterling
Derivatives related to debt/liquid assets	558	4
Derivatives related to securities	–	–
Derivatives related to transactions	15	40
Total	573	44

The hedges of forecasted sales and purchases account for a part of the sensitivity calculated above. They are concluded to offset the effect of changes in foreign currency related to forecasted transactions by the businesses. These forecasted transactions are not financial instruments and therefore are not recorded in the accounts of the Company. The hedges related to these forecasted transactions are recorded as cash flow hedges. The results from such hedges currently deferred in equity amount to a loss of EUR 9 million. This loss will be released to the income statement in 2002 when the related hedged transactions affect the income statement.

Virtually all transaction hedges that were outstanding at December 31, 2001 were forward foreign exchange contracts that will expire in 2002. During 2001 no results were recorded in the income statement as a result of ineffectiveness of these hedges.
Changes in fair value of hedges related to accounts payable, receivable, external debt and intercompany loans are recognized in the income statement. The changes in fair value of these hedges are partly offset by changes in fair value of the hedged items in the income statement. All fair value hedges are forward exchange contracts or cross currency basis swaps.

Interest rate risk

At year-end 2001, Philips had a ratio of fixed-rate debt to total outstanding debt of approximately 69%, compared to 48% one year earlier. The Company partially hedges the interest-rate risk inherent in the external debt. As of year-end 2001, the Company hedged a notional amount of USD 146 million, compared to current outstanding USD-denominated fixed-rate public debt of USD 1,063 million, EUR 700 million compared to outstanding EUR-denominated fixed-rate public debt of EUR 4,948 million, and TWD 12,999 million compared to an investment of TWD 12,999 million.

The Company also entered into five interest rate swaps, paying fixed interest on EUR 110 million and receiving fixed interest on EUR 64 million for general asset and liability management purposes.
Interest rate swaps hedge the Company against adverse movements of long-term interest rates. These interest rate hedges related to bonds or investments are fair value hedges; thus profits resulting from the hedges (EUR 41 million in 2001) are offset by equal and opposite losses recorded on the underlying financial instruments in the income statement. At inception of an interest rate swap, the Company requires the correlation between the hedged item and the interest rate swap to match. At December 31, 2001, the condition of correlation continued to exist, therefore there was no hedge ineffectiveness during the year on interest rate swaps. Some interest rate hedges related to bonds were unwound during 2001. The gains on these hedges will be released over the remaining life of the underlying financial instruments to the income statement. In 2002 it is expected that a gain of EUR 5 million will be released. As the fixed flows of the swaps match exactly the coupons of the underlying financial instruments, the hedges are deemed to be effective. No results were released to the income statement as a result of ineffectiveness of interest rate hedges in 2001. The results on other interest rate swaps are recognized in the income statement.

As of December 31, 2001, the majority of debt consisted of bonds. Of the EUR 6,152 million of outstanding bonds, 4.9% have a so-called ‘embedded put’ feature, which allows the investor to ask for redemption of the bonds in one specific month prior to their final maturity date.

A sensitivity analysis shows that if long-term interest rates were to decrease instantaneously by 1% from their level of December 31, 2001, with all other variables (including foreign exchange rates) held constant, the fair value of the long-term debt and investments would increase by EUR 282 million. In this case the fair value of debt and investments plus the fair value of related interest rate swaps would increase by EUR 267 million (compared to EUR 106 million in 2000). This increase is based on the assumption that the ‘putable’ bonds will be repaid at their final maturity date. If the bondholders required payment at their respective put dates and there was an increase in interest rates by 1%, this would reduce the market value of the bonds and investments by EUR 235 million. In this case the fair value of debt and investments plus the fair value related to interest rate swaps would decrease by EUR 221 million (compared to EUR 71 million in 2000).

Other financial risks

Other financial risks include the equity price risk, the commodity price risk and the credit risk.

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

In 2001, an impairment loss of EUR 526 million was recognized on the security investments in Vivendi Universal and GN Great Nordic in view of the extended period of time during which the market value of these shares was below cost.
In addition to TSMC, Vivendi and Great Nordic, Philips is a shareholder of other publicly listed companies such as Atos Origin, ASML, FEI, JDS Uniphase and MedQuist and therefore is exposed to the equity price risk through movements in the share prices of these companies. The aggregate market value of all these investments exceeded the book value by EUR 8,838 million at year-end 2001.

The Company is a purchaser of certain base metals (such as copper), precious metals and energy. The Company maintains a commodity price risk management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations caused by commodity price volatility. The commodity price derivatives that the Company enters into are concluded as cash flow hedges to offset forecasted purchases.
Credit risk represents the loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. As of December 31, 2001, the Company identified 3 customers with significant exposure. This exposure amounts to EUR 201 million in total and ranges from EUR 58 million to EUR 79 million per customer. To reduce exposure to credit risk, the Company performs ongoing credit evaluations of the financial condition of its customers but generally does not require collateral.

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

Fair value of financial assets and liabilities

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

	December 31, 2001		December 31, 2000	
	carrying amount	estimated fair value	carrying amount	estimated fair value
Assets:				
Cash and cash equivalents	**890**	**890**	1,089	1,089
Securities	**130**	**692**	111	1,189
Accounts receivable - current	**5,812**	**5,812**	6,500	6,500
Other financial assets	**2,789**	**2,789**	3,747	3,631
Accounts receivable - non-current	**306**	**272**	303	269
Derivative instruments	**237**	**237**	423	423
Liabilities:				
Accounts payable	**(3,243)**	**(3,243)**	(4,255)	(4,255)
Debt	**(7,866)**	**(7,945)**	(4,027)	(4,061)

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

Cash, accounts receivable and accounts payable

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

Cash equivalents

The fair value is based on the estimated aggregate market value.

Securities

The fair value of equity investments is based on quoted market prices.

Other financial assets

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

Debt

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

Derivative instruments

The fair value is the amount that the Company would receive or pay to terminate the derivative instruments, considering currency exchange rates and remaining maturities.

27 Application of Generally Accepted Accounting Principles in the United States of America

The accounting policies followed in the preparation of the consolidated financial statements differ in some respects from those generally accepted in the United States of America.

To determine net income and stockholders' equity in accordance with generally accepted accounting principles in the United States of America (US GAAP), Philips has applied the following accounting principles:

- In 2001, Philips charged net income for an amount of EUR 133 million related to amortization of goodwill for LG.Philips Displays and the medical systems businesses acquired from Marconi and Agilent after June 30, 2001. Under US GAAP, no goodwill amortization is allowed according to SFAS 142, but an impairment test is required. For US GAAP purposes, the amortization is eliminated from income and capitalized.
- Philips rents a portion of its property, plant and equipment through sale and lease-back transactions. Under Dutch GAAP, the difference between the net proceeds and the book value is accounted for under 2001 income. Under US GAAP, this income has to be recognized proportionally during the terms of the lease. The unrecognized portion of EUR 27 million (net of taxes) is therefore reversed from 2001 income.
- Under Dutch GAAP, securities available for sale are valued at the lower of cost or net realizable value. Under US GAAP they are valued at market price, unless such shares are restricted by contract for a period of one year or more, and changes in unrealized gains or losses with respect to securities available for sale are credited or charged to stockholders' equity.
- Prior to the year 2000, under Dutch GAAP, the results of foreign-exchange contracts relating to hedges of securities, when sale is restricted for a period of one year or more, were deferred to stockholders' equity (EUR 90 million). Under US GAAP, changes in the value of these forward exchange contracts are reported in income. On January 1, 2000 the Company adopted SFAS No. 133 as its accounting policy for derivative instruments for both Dutch GAAP and US GAAP. However, the resulting cumulative effect of the change in accounting principle is EUR 58 million gain under Dutch GAAP and EUR 32 million loss under US GAAP because of the differences in accounting for derivatives which existed prior to adoption of SFAS No. 133.
- Philips reported a charge to income from operations of EUR 329 million for restructuring in its 1998 financial statements. With regard to a portion of this restructuring, EUR 40 million (EUR 23 million net of taxes), the plans had not been communicated to employees until early 1999 and, accordingly, this portion was recorded under US GAAP as a charge in 1999.
- Under Dutch GAAP, the excess of the Company's investment over its underlying equity in the net assets of unconsolidated companies has been classified as goodwill under intangible fixed assets, whereas under US GAAP it would be included in investments in unconsolidated companies.
- During the year ended December 31, 2001, the Company recognized gains on divestments which totaled EUR 287 million (2000: EUR 1,429 million). Under Dutch GAAP, these gains are classified in the consolidated statement of income as other business income, which is included as part of income from operations, whereas under US GAAP, such gains are reported separately under income before taxes.
- Under Dutch GAAP, additional write-downs of inventory, as part of restructuring projects, are recorded under a separate caption in income from operations, being restructuring and impairment charges, whereas under US GAAP they would be included under cost of sales.

Reconciliation of net income according to Dutch GAAP versus US GAAP

	2001	2000	1999
Income (loss) from continuing operations as per the consolidated statements of income	**(2,604)**	9,602	1,804
Cumulative effect of a change in accounting principle in 2000 and reclassification of extraordinary items under Dutch GAAP	**–**	5	–
	(2,604)	9,607	1,804
Adjustments to US GAAP:			
Additional minimum liabilities under SFAS No. 87	**–**	(16)	(62)
Provisions for restructuring not recognized in 1998	**–**	–	(23)
Reversal of cash flow hedges on securities available for sale	**–**	–	(90)
Adjustments to unconsolidated companies – net	**36**	(14)	–
Reversal of goodwill amortization due to SFAS No. 142	**133**	–	–
Reversal of gain on sale and lease-back	**(27)**	–	–
Other items	**(13)**	–	(34)
Income (loss) from continuing operations in accordance with US GAAP before discontinued operations, extraordinary items and cumulative effect of change in accounting principle	**(2,475)**	9,577	1,595
Extraordinary items – net	**–**	–	(5)
Cumulative effect of a change in accounting for derivative instruments and hedging activities – net	**–**	85	–
Net income (loss) in accordance with US GAAP	**(2,475)**	9,662	1,590
Basic earnings per common share in EUR:			
Income (loss) from continuing operations	**(1.94)**	7.30	1.16
Extraordinary items – net	**–**	–	(0.01)
Cumulative effect of a change in accounting principle	**–**	0.06	–
Net income (loss)	**(1.94)**	7.36	1.15
Diluted earnings per common share in EUR:			
Income (loss) from continuing operations	**(1.94)**	7.22	1.15
Cumulative effect of a change in accounting principle	**–**	0.06	–
Net income (loss)	**(1.94)**	7.28	1.15

In addition to the reconciliation of net income, 'comprehensive income' is required to be reported under US GAAP.

Comprehensive income is defined as all changes in the equity of a business enterprise during a period, except investments by, and distributions to, equity owners. Accordingly, comprehensive income consists of net income and other items that are reflected in stockholders' equity on the balance sheet and have been excluded from the income statement. Such items of other comprehensive income include foreign currency translation adjustments, the change in the fair value of certain derivatives qualifying for hedge treatment, certain pension liability-related losses and unrealized holding gains and losses on securities available for sale.

Statement of comprehensive income

	2001	2000	1999
Net income (loss) in accordance with US GAAP	(2,475)	9,662	1,590
Other comprehensive income (net of taxes):			
Cumulative effect of a change in accounting for derivative instruments and hedging activities	–	(32)	–
Translation differences	102	65	419
Cash flow hedges	22	132	(71)
Minimum pension liability	(5)	–	43
Unrealized gains on securities available for sale	(406)	(1,191)	2,131
Comprehensive income (loss) in accordance with US GAAP	(2,762)	8,636	4,112

The accumulated balances for each item of other comprehensive income are as follows:

	translation differences	unrealized gains on securities available for sale	minimum pension liability	cash flow hedges	accumulated other comprehensive income
Beginning balance	(868)	972	(13)	(29)	62
Net current period change	102	(522)	(18)	(18)	(456)
Reclassification adjustments for gains (losses) reclassified into income	–	116	13	40	169
Ending balance	(766)	566	(18)	(7)	(225)

Net current period change is net of income taxes of EUR 10 million and EUR 5 million related to the minimum pension liability and cash flow hedges respectively.

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

	2001	2000
Stockholders' equity as per the consolidated balance sheets	18,453	21,736
Equity adjustments that affect net income:		
Intangible assets relating to additional liabilities under SFAS No. 87	–	13
Unconsolidated companies	22	(14)
Goodwill related to acquisitions after June 30, 2001 (SFAS No. 142)	133	–
Sale and lease-back transactions	(27)	–
Equity adjustments not affecting net income under US GAAP:		
Unrealized gains on securities available for sale	566	972
SFAS No. 87 additional liabilities recognized in prior years	13	–
Stockholders' equity in accordance with US GAAP	19,160	22,707

Changes in unrealized gains on securities available for sale in 2001 primarily relate to the lower market value of the JDS Uniphase shares as compared to the market value as at December 31, 2000.

28 Information relating to product sectors and main countries

In order to improve financial transparency to Philips' shareholders and the financial community at large, the Board decided in 2000 that separate results will be published for all divisions. As a consequence, the following 9 product sectors are distinguished: Lighting, Consumer Electronics, Domestic Appliances and Personal Care, Components, Semiconductors, Medical Systems, Origin (deconsolidated from October 1, 2000 onwards), Miscellaneous and Unallocated.

On February 8, 2001 it was announced that the activities listed under the Consumer Electronics sector, Specialty Products, would be reallocated within the Group. As a result, Speaker Systems, Remote Control Systems, Creative Display Solutions and Imaging were transferred to the Components sector, with all remaining businesses, with the exception of Institutional TV, Accessories and Broadcast Networks, being assigned to the Miscellaneous sector. Prior years have been restated accordingly.

Lighting

Philips is the leader in the world lighting market. A wide variety of applications are served by a full range of incandescent and halogen lamps, automotive lamps, high-intensity gas-discharge and special lamps, QL induction lamps, fixtures, ballasts and lighting electronics.

Consumer Electronics

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

Domestic Appliances and Personal Care

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

Components

Philips Components is a major provider of integrated digital electronic solutions in the areas of displays, storage and connectivity. Its global customer base covers the computing, consumer electronics, telecommunications and automotive industries. It produces modules for optical storage in CD and DVD formats and mobile display systems for use in cellular phones. It also produces wireless connectivity modules to address the digital, Internet-driven, 24/7 world. It also encompasses speaker systems, remote control systems, creative display solutions and imaging.

Semiconductors

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

Medical Systems

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

Origin

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

Miscellaneous

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

Unallocated

The sector Unallocated includes general and administrative expenses in the corporate center and the country organizations.

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

Product sectors

2001

	sales (to third parties)	segment revenues	income (loss) from operations	as a % of segment revenues	results relating to unconsolidated companies
Lighting	5,083	5,122	623	12.2	(13)
Consumer Electronics	11,052	11,233	(649)	(5.8)	–
DAP	2,224	2,246	334	14.9	–
Components	2,772	3,705	(667)	(18.0)	(505)
Semiconductors	4,389	4,940	(607)	(12.3)	(154)
Medical Systems	4,834	4,836	(199)	(4.1)	1
Miscellaneous	1,985	2,154	(104)	(4.8)	(79)
Unallocated	–		(102)		(4)
Total	**32,339**	**34,236**	**(1,371)**		**(754)**
Intersegment revenues		**(1,897)**			
Sales		**32,339**			
Income from operations as a % of sales			**(4.2)**		

2000

	sales (to third parties)	segment revenues	income (loss) from operations	as a % of segment revenues	results relating to unconsolidated companies
Lighting	5,052	5,097	668	13.1	(33)
Consumer Electronics	13,060	13,277	410	3.1	(4)
DAP	2,107	2,130	287	13.5	–
Components	5,042	6,920	608	8.8	211
Semiconductors	5,879	6,812	1,346	19.8	1,151
Medical Systems	3,031	3,047	169	5.5	(3)
Origin	717	1,164	1,063	91.3	(2)
Miscellaneous	2,974	3,378	(191)	(5.7)	2,647
Unallocated	–	–	(79)		3
Total	37,862	41,825	4,281		3,970
Intersegment revenues		(3,963)			
Sales		37,862			
Income from operations as a % of sales			11.3		

1999

	sales (to third parties)	segment revenues	income (loss) from operations	as a % of segment revenues	results relating to unconsolidated companies
Lighting	4,548	4,597	602	13.1	(1)
Consumer Electronics	11,152	11,451	255	2.2	(1)
DAP	1,791	1,817	220	12.1	–
Components	4,101	5,947	293	4.9	187
Semiconductors	3,796	4,557	614	13.5	259
Medical Systems	2,493	2,495	181	7.3	(9)
Origin	1,056	1,735	97	5.6	–
Miscellaneous	2,522	2,869	(118)	(4.1)	(25)
Unallocated	–	–	(393)		(1)
Total	31,459	35,468	1,751		409
Intersegment revenues		(4,009)			
Sales		31,459			
Income from operations as a % of sales			5.6		

Product sectors

2001

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation
Lighting	2,936	2,020	888	1,487	224	179
Consumer Electronics	3,429	672	2,660	551	202	265
DAP	1,084	652	432	571	105	81
Components	4,083	397	730	2,255	475	267
Semiconductors	8,303	4,742	927	4,431	956	943
Medical Systems	7,926	5,382	2,471	4,844	86	75
Miscellaneous	2,734	314	837	427	95	86
Unallocated	7,959	122	3,552	421	–	73
Total	**38,454**	**14,301**	**12,497**	**14,987**	**2,143**	**1,969**

2000

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation
Lighting	2,944	1,903	947	1,383	258	171
Consumer Electronics	4,643	1,486	3,092	644	335	195
DAP	1,131	752	379	564	96	77
Components	5,740	2,158	1,499	3,301	639	332
Semiconductors	8,501	4,572	1,283	4,233	1,631	692
Medical Systems	3,982	2,821	1,157	2,429	58	47
Origin	1,449	–	–	–	18	43
Miscellaneous	1,912	819	1,057	531	135	188
Unallocated	8,239	(154)	2,895	383	–	44
Total	38,541	14,357	12,309	13,468	3,170	1,789

1999

	total assets	net operating capital	total liabilities excl. debt	long-lived assets	capital expenditures	depreciation
Lighting	2,849	1,875	849	1,275	176	161
Consumer Electronics	3,998	1,285	2,697	596	271	52
DAP	777	459	314	256	76	67
Components	5,340	2,151	1,237	3,244	253	417
Semiconductors	5,188	3,194	928	2,917	622	467
Medical Systems	1,840	1,023	807	640	41	38
Origin	683	240	415	275	56	68
Miscellaneous	1,797	1,012	750	527	81	238
Unallocated	7,312	(1,081)	3,383	424	86	40
Total	29,784	10,158	11,380	10,154	1,662	1,548

Main countries

2001	sales (to third parties)	total assets	net operating capital	long-lived assets	capital expenditures	depreciation
Netherlands	1,555	5,253	2,807	1,779	403	333
United States	8,901	10,593	6,899	6,802	386	516
Germany	2,648	1,831	508	711	226	123
France	1,990	4,794	85	377	157	182
United Kingdom	1,560	752	448	210	46	48
China	2,205	1,428	213	523	224	171
Other countries	13,480	13,803	3,341	4,585	701	596
Total	**32,339**	**38,454**	**14,301**	**14,987**	**2,143**	**1,969**

2000	sales (to third parties)	total assets	net operating capital	long-lived assets	capital expenditures	depreciation
Netherlands	1,696	8,593	2,932	1,885	638	369
United States	9,126	8,802	5,820	5,051	573	349
Germany	3,272	1,644	128	672	194	132
France	2,333	2,749	222	474	205	120
United Kingdom	2,179	951	526	337	89	61
China	2,683	2,113	783	814	295	156
Other countries	16,573	13,689	3,946	4,235	1,176	602
Total	37,862	38,541	14,357	13,468	3,170	1,789

1999	sales (to third parties)	total assets	net operating capital	long-lived assets	capital expenditures	depreciation
Netherlands	1,619	7,740	2,151	1,811	435	370
United States	7,535	5,139	2,839	2,476	249	228
Germany	2,727	1,558	86	632	134	147
France	1,962	1,118	164	392	92	113
United Kingdom	2,281	1,041	607	321	55	53
China	2,023	1,570	635	635	91	123
Other countries	13,312	11,618	3,676	3,887	606	514
Total	31,459	29,784	10,158	10,154	1,662	1,548

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

in millions of euros

The balance sheets are presented before appropriation of profit

Balance sheets as of December 31

		2001		2000
Assets				
Current assets:				
Cash and cash equivalents	25		16	
(A) Securities	127		111	
(B) Receivables	2,173		1,691	
		2,325		1,818
Non-current assets:				
(C) Investments in affiliated companies	21,787		20,923	
(D) Other non-current financial assets	2,423		3,418	
(E) Tangible fixed assets	1		1	
(F) Intangible fixed assets	2,977		2,306	
		27,188		26,648
Total		29,513		28,466
Liabilities and stockholders’ equity				
Current liabilities:				
(G) Other liabilities	364		355	
(H) Short-term debt	4,109		4,075	
(I) Short-term provisions	7		72	
		4,480		4,502
Non-current liabilities:				
(J) Long-term debt	6,368		2,053	
(I) Long-term provisions	212		175	
		6,580		2,228
(K) Stockholders’ equity:				
Issued, paid-up capital	263		263	
Share premium account	13		7	
Reserves	20,781		11,864	
Undistributed profit (loss) for the year	(2,604)		9,602	
		18,453		21,736
Total		29,513		28,466

Statements of income

	2001	2000
Income (loss) after taxes from affiliated companies	(1,929)	3,842
Other income after taxes	(675)	5,760
(L) **Net income (loss)**	(2,604)	9,602

Notes to the financial statements of Royal Philips Electronics

all amounts in millions of euros unless otherwise stated

With respect to the accounting policies, see pages 38-46 of the consolidated financial statements, which form part of these notes.

A Securities

See note to the Group financial statements.

B Receivables

	2001	2000
Trade accounts receivable	**250**	210
Group companies	**1,646**	992
Unconsolidated companies	**30**	29
	1,926	1,231
Other receivables	**30**	42
Advances and prepaid expenses	**3**	2
Deferred tax assets	**270**	13
Income tax receivable	**10**	14
Derivative instruments	**(66)**	389
Total	**2,173**	1,691

An amount of EUR 185 million included in receivables is due after one year (2000: EUR 27 million).

C Investments in affiliated companies

The investments in affiliated companies are included in the balance sheet based on their net asset value in conformity with the aforementioned accounting principles of the consolidated financial statements, or their purchase price.

	total	investments	loans
Balance as of January 1, 2001	20,923	14,456	6,467
Changes:			
Acquisitions/additions	5,388	2,859	2,529
Sales/redemptions	(2,150)	(1,031)	(1,119)
After-tax income from affiliated companies	(1,929)	(1,929)	–
Dividends received	(1,003)	(1,003)	–
Translation differences/other changes	558	272	286
Balance as of December 31, 2001	**21,787**	**13,624**	**8,163**

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

D Other non-current financial assets

	total	security investments	other receivables
Balance as of January 1, 2001	3,418	3,412	6
Changes:			
Acquisitions/additions	38	38	–
Sales/redemptions	(507)	(507)	–
Value adjustments	(526)	(526)	–
Balance as of December 31, 2001	**2,423**	**2,417**	**6**

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

Included are Vivendi Universal shares and GN Great Nordic shares. The redeemable preferred shares of LG Electronics Inc. of Korea, included in the balance as of January 1, 2001, were redeemed in the year 2001. See note 12 to the Group financial statements and the relevant notes.

E Tangible fixed assets

Balance as of January 1, 2001:	
Cost	1
Accumulated depreciation	–
Book value	1
Changes in book value:	
Capital expenditures	–
Retirements and sales	–
Depreciation and write-downs	–
Total changes	–
Balance as of December 31, 2001:	
Cost	1
Accumulated depreciation	–
Book value	**1**

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

F Intangible fixed assets

Balance as of January 1, 2001:	
Acquisition cost	2,482
Accumulated amortization	(176)
Book value	2,306
Changes in book value:	
Acquisitions	984
Amortization and write-downs	(313)
Total changes	671
Balance as of December 31, 2001:	
Acquisition cost	3,426
Accumulated amortization	(449)
Book value	**2,977**

The intangible fixed assets represent goodwill paid upon acquisitions. The acquisitions in 2001 mainly relate to LG.Philips Displays.

The amortization period ranges between 5 and 15 years.

G Other liabilities

	2001	2000
Other short-term liabilities	65	82
Deferred income and accrued expenses	299	273
Total	**364**	355

H Short-term debt

Short-term debt includes outstanding commercial paper for an amount of EUR 521 million, the current portion of outstanding long-term debt amounting to EUR 160 million (2000: EUR 430 million), debt to other Group companies totaling EUR 3,206 million (2000: EUR 2,798 million) and institutional financing totaling EUR 222 million (2000: EUR 847 million).

I Provisions

	2001	2000
Pensions	19	21
Other	200	226
Total	**219**	247
Of which long-term	212	175
Of which short-term	7	72

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

J Long-term debt

	range of interest rates	average rate of interest	amount outstanding	due in 2002	due after 2002	due after 2006	average remaining term (in years)
Convertible debentures	1.6	1.6	134	–	134	–	3.5
Other debentures	5.0-8.8	6.1	6,249	145	6,104	3,060	5.3
Intercompany financing	1.8-3.8	2.8	1,119	1,119	–	–	–
Other long-term debt	5.4-7.0	5.7	145	15	130	30	3.7
Total		**5.5**	**7,647**	**1,279**	**6,368**	**3,090**	
Corresponding data previous year		6.7	3,858	1,805	2,053	1,029	

The following amounts of the long-term debt as of December 31, 2001 are due in the next five years:

2002	1,279
2003	222
2004	2,381
2005	302
2006	373
	4,557
Corresponding amount previous year	2,829

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

K Stockholders' equity

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

L Net income

Net income in 2001 amounted to a loss of EUR 2,604 million (2000: net income of EUR 9,602 million).
For the remuneration of past and present members of both the Board of Management and the Supervisory Board, please refer to the statement on page 60 and 61 of the consolidated financial statements.

M Employees

The number of persons employed by Royal Philips Electronics at year-end 2001 was 13 (2000: 14) and included the members of the Board of Management and most members of the Group Management Committee.

N Obligations not appearing in the balance sheet

General guarantees as defined in Book 2, Section 403 of the Netherlands Civil Code have been given by Royal Philips Electronics on behalf of several Group companies in the Netherlands. The liabilities of these companies to third parties and unconsolidated companies totaled EUR 1,309 million as of year-end 2001 (2000: EUR 1,674 million).
Guarantees totaling EUR 679 million (2000: EUR 600 million) have also been given on behalf of other Group companies, and guarantees totaling EUR 506 million (2000: EUR 439 million) on behalf of unconsolidated companies and third parties.

February 5, 2002

The Supervisory Board

The Board of Management

Other information regarding Royal Philips Electronics

Auditors' report

Introduction

We have audited the 2001 financial statements of Koninklijke Philips Electronics N.V. appearing on pages 38 to 104. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2001 and the results of its operations for the year then ended in accordance with accounting principles generally accepted in the Netherlands and comply with the financial reporting requirements included in Part 9, Book 2 of the Netherlands Civil Code.

Eindhoven, February 5, 2002
KPMG Accountants N.V.

Proposed distribution to shareholders of Royal Philips Electronics

Pursuant to article 38 of the Articles of Association, and with the approval of the Supervisory Board and the Meeting of Priority Shareholders, a proposal will be submitted to the General Meeting of Shareholders to make a distribution in cash to shareholders of EUR 0.36 per common share from the other reserves (2000: a dividend was declared of EUR 0.36 per common share). This will result in a reduction of other reserves of the Company by EUR 459 million.

Remuneration of the Board of Management and Supervisory Board

Remuneration

The total remuneration and related costs (in euros) of the members of the Board of Management in 2001 can be specified as follows:

	2001	2000
Salaries	3,094,826	3,758,811
Bonuses	1,971,707	2,242,922
	5,066,533	6,001,733
Pension charges*	(2,023,000)	(1,559,000)
Total	3,043,533	4,442,733

* The negative amount of pension charges is mainly due to negative net periodic pension costs related to pensions funded by the Dutch Philips Pension Fund.

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

	2001			2000		
	salary	bonus*	total	salary	bonus*	total
G.J. Kleisterlee [1]	721,775	248,520	970,295	400,839	–	400,839
J.H.M. Hommen	635,292	370,625	1,005,917	612,603	432,906	1,045,509
A.P.M. van der Poel	635,292	355,310	990,602	612,603	318,327	930,930
J.W. Whybrow	635,292	354,927	990,219	612,603	302,671	915,274
C. Boonstra [2]	313,826	562,687	876,513	907,560	900,300	1,807,860
A. Baan [3]	153,349	79,638	232,987	612,603	218,382	830,985
Subtotal	3,094,826	1,971,707	5,066,533	3,758,811	2,172,586	5,931,397
Former member	–	–	–	–	70,336	70,336
Total	3,094,826	1,971,707	5,066,533	3,758,811	2,242,922	6,001,733

* The bonuses paid are related to the level of performance achieved in the previous year.

1) Bonus figures 2001 relate to period April-December 2000; salary figure 2000 related to period April-December 2000.
2) Salary figures 2001 relate to period January-April 2001.
3) Salary figures 2001 relate to period January-March 2001.

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

	number of options				amounts in euros		
	as of Jan. 1, 2001	granted during 2001	exercised during 2001	as of Dec. 31, 2001	exercise price	share price on exercise date	expiry date
G.J. Kleisterlee	27,200[b])		27,200	–	7.74	38.63[c])	25.02.2001
	12,000[b])			12,000[b])	9.40		13.02.2002
	12,000[b])			12,000[b])	16.66		12.02.2003
	60,000[b])			60,000[b])	15.97		11.02.2004
	60,000[a/b])			60,000[a/b])	42.24		17.02.2010
	–	120,000[a])		120,000[a])	37.60		08.02.2011
J.H.M. Hommen	480,000			480,000	9.84		13.02.2002
	80,000			80,000	17.10		12.02.2003
	80,000			80,000	16.41		11.02.2004
	80,000[a])			80,000[a])	42.24		17.02.2010
	–	80,000[a])		80,000[a])	37.60		08.02.2011
A.P.M. van der Poel	40,000		20,000	20,000	17.10	33.00	12.02.2003
	80,000			80,000	16.41		11.02.2004
	80,000[a])			80,000[a])	42.24		17.02.2010
	–	80,000[a])		80,000[a])	37.60		08.02.2011
J.W. Whybrow	80,000			80,000	16.41		11.02.2004
	80,000[a])			80,000[a])	42.24		17.02.2010
	–	80,000[a])		80,000[a])	37.60		08.02.2011
Total	1,251,200	360,000	47,200	1,564,000			

[a]) 50% fixed options and 50% performance-related options
[b]) awarded before date of appointment as a member of the Board of Management
[c]) shares not sold but retained in depot with bank

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

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

	age at 31-12-2001	ultimate retirement age	increase in accrued pension during 2001	accumulated annual pension as at December 31,
G.J. Kleisterlee	55	62	13,525	316,845
J.H.M. Hommen	58	62	19,969	94,984
A.P.M. van der Poel	53	62	13,051	238,079
J.W. Whybrow	54	62	13,051	332,311

Supervisory Board

During 2001 the individual members of the Supervisory Board received, by virtue of the positions they held, the following remuneration (in euros):

	2001			2000		
	membership	committees	total	membership	committees	total
L.C. van Wachem	74,874	9,076	83,950	74,874	9,076	83,950
W. de Kleuver	40,840	9,076	49,916	40,840	9,076	49,916
W. Hilger (Jan./March)	20,420	2,269	22,689	40,840	9,076	49,916
L. Schweitzer	40,840	–	40,840	40,840	–	40,840
R. Greenbury	40,840	4,538	45,378	40,840	4,538	45,378
J-M. Hessels	40,840	4,538	45,378	40,840	3,403	44,243
K.A.L.M. van Miert	40,840	2,269	43,109	40,840	–	40,840
	299,494	31,766	331,260	319,914	35,169	355,083
C.J. Oort (Jan./March)	–	–	–	20,420	1,134	21,554
	299,494	31,766	331,260	340,334	36,303	376,637

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

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

	number of shares	
	as of December 31, 2001	as of January 1, 2001
L.C. van Wachem	17,848	17,848
L. Schweitzer	1,070	1,070
G.J. Kleisterlee	27,200	–

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

Corporate governance of the Philips Group

General

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

The management of the Company is entrusted to the Board of Management under the supervision of the Supervisory Board. The activities of the Philips Group are organized in product divisions, which are responsible for the worldwide business policy. Philips has more than 150 production sites in over 25 countries and sales and service outlets in some 150 countries. It delivers products, systems and services in the fields of lighting, consumer electronics and communications, domestic appliances and personal care, components, semiconductors, medical systems, business electronics and information technology. The Company's activities are grouped in eight sectors: Lighting, Consumer Electronics, Domestic Appliances and Personal Care, Components, Semiconductors, Medical Systems, Miscellaneous and Unallocated.

The statutory seat of the Company is Eindhoven, the Netherlands, and the statutory list of all subsidiaries and affiliated companies, prepared in accordance with the relevant legal requirements (The Netherlands Civil Code, Book 2, Articles 379 and 414), forms part of the notes to the consolidated financial statements and is deposited at the office of the Commercial Register in Eindhoven, the Netherlands (file no. 1910).

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

Board of Management and Supervisory Board

The Board of Management is *responsible for* the effective management of the business. It is required to keep the Supervisory Board informed of developments, to consult it on important matters and to submit certain important decisions to it for its prior approval. The Board of Management *consists of* at least three members (currently four), who are elected for an indefinite period by the General Meeting of Shareholders. *Individual data* on the members of the Board of Management are printed on page 58 of the separate booklet entitled 'Management Report'. The President is *appointed by* the General Meeting of Shareholders. Members of the Board of Management may be *suspended by* the Supervisory Board and the General Meeting of Shareholders and *dismissed by* the latter. The *remuneration of* the members of the Board of Management is determined by the Supervisory Board upon a proposal from the President and on the advice of the Remuneration Committee of the Supervisory Board.

The Supervisory Board is independent of the Board of Management and is *responsible for* supervising both the policies of the Board of Management and the general direction of the Group's business. It is also required to advise the Board of Management. The Supervisory Board *consists of* at least five members (currently six). They elect a Chairman, Vice-Chairman and Secretary from their midst. The Board has *three permanent committees*: an Audit Committee, a Remuneration Committee and a Nomination and Selection Committee. These committees advise the plenary Supervisory Board. The Supervisory Board has adopted *Rules of Procedure* to consolidate its own governance rules. The *profile* for the Supervisory Board's composition and *additional data* on the individual members are given on pages 60 to 62 of the separate booklet entitled 'Management Report'. Members of the Supervisory Board are *appointed by* the General Meeting of Shareholders for fixed terms of four years, and may be re-elected for two additional four-year terms. In exceptional cases, however, the Supervisory Board and the Meeting of Priority Shareholders may deviate from this rule. Members of the Supervisory Board may be suspended or dismissed by the General Meeting of Shareholders. Their *remuneration* is fixed by the General Meeting of Shareholders.

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

Group Management Committee

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

General Meeting of Shareholders

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

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

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

There are *ten priority shares*. Eight are held by the Dr. A.F. Philips-Stichting, with Messrs F.J. Philips and H.A.C. van Riemsdijk each holding one. The self-electing Board of the *Dr. A.F. Philips-Stichting* consists of the Chairman and the Vice-Chairman and Secretary of the Supervisory Board, certain other members of the Supervisory Board, and the President of the Company. At present, the Board consists of Messrs L.C. van Wachem, W. de Kleuver, J-M. Hessels, K.A.L.M. van Miert and G.J. Kleisterlee.

A *Meeting of Priority Shareholders* is held at least once a year, at least thirty days before the General Meeting of Shareholders. Approval of the Meeting of Priority Shareholders is required for resolutions of the General Meeting of Shareholders regarding the issue of shares or rights to shares, the cancellation of shares, amendments to the Articles of Association, and the liquidation of the Company. Acting in agreement with the Supervisory Board, the Meeting also makes a *binding recommendation* to the General Meeting of Shareholders for the appointment of members of the Board of Management and the Supervisory Board, which can be overruled by the General Meeting of Shareholders as set out before.

Preference shares and the Stichting Preferente Aandelen Philips

The *authorized share capital* of the Company consists of ten priority shares, 3,250,000,000 ordinary shares and 3,249,975,000 preference shares. The *Stichting Preferente Aandelen Philips ('the Foundation')* has been granted the *right to acquire preference shares* in the Company. The mere notification that the Foundation wishes to exercise its rights, should a third party ever seem likely to gain a controlling interest in the Company, will result in the preference shares being effectively issued. The Foundation may exercise this right for as many preference shares as there are ordinary shares in the Company outstanding at that time. The object of the Foundation is to represent the interests of the Company, the enterprises maintained by the Company and its affiliated companies within the Philips Group, such that the interests of Philips, those enterprises and all parties involved with them are safeguarded as effectively as possible, and that they are afforded maximum protection against influences which, in conflict with those interests, may undermine the autonomy and identity of Philips and those enterprises, and also to do anything related to the above ends or conducive to them.

The *members of the self-electing Board of the Foundation* are Messrs J.R. Glasz, S.D. de Bree, W.E. Scherpenhuijsen Rom, L.C. van Wachem and G.J. Kleisterlee. As Chairman of the Supervisory Board and the Board of Management respectively, Messrs Van Wachem and Kleisterlee are members of the Board ex officio. Mr Kleisterlee is not entitled to vote.

The Board of Management of the Company and the Board of the Stichting Preferente Aandelen Philips declare that they are jointly of the opinion that the Stichting Preferente Aandelen Philips is *independent* of the Company as required by the Listing Requirements of Euronext Amsterdam N.V.'s stock market.

The Philips Group in the last eight years *

all amounts in millions of euros unless otherwise stated
Due to factors such as consolidations and divestments, the amounts, percentages and ratios are not directly comparable.

General data

	2001	2000	1999	1998	1997	1996	1995	1994
Sales	**32,339**	37,862	31,459	30,459	29,658	27,094	25,259	23,768
Percentage increase over previous year	**(15)**	20	3	3	9	7	6	2
Income (loss) from continuing operations	**(2,604)**	9,602	1,804	541	1,231	126	971	683
Discontinued operations	**–**	–	–	5,054	263	202	247	281
Net income (loss)	**(2,604)**	9,602	1,799	6,053	2,602	(268)	1,143	964
Turnover rate of net operating capital	**2.15**	3.16	3.14	2.91	2.84	2.70	2.88	2.95
Total employees at year-end (in thousands)	**189**	219	227	234	252	250	253	241
Salaries, wages and social costs paid	**8,100**	8,456	8,016	8,209	8,261	8,083	7,363	7,031

Income

	2001	2000	1999	1998	1997	1996	1995	1994
Income (loss) from operations	**(1,371)**	4,281	1,751	685	1,714	422	1,350	1,227
As a % of sales	**(4.2)**	11.3	5.6	2.2	5.8	1.6	5.3	5.2
As a % of net operating capital (RONA)	**(9.1)**	35.7	17.5	6.5	16.4	4.2	15.4	15.2
Income taxes	**421**	(570)	(336)	(41)	(276)	7	(74)	(135)
As a % of income before taxes	**18**	(9)	(19)	(11)	(20)	40	(7)	(16)
Income (loss) after taxes	**(1,865)**	5,699	1,447	332	1,119	25	964	696
As a % of sales	**(5.8)**	15.1	4.6	1.1	3.8	0.1	3.8	2.9
Income (loss) from continuing operations	**(2,604)**	9,602	1,804	541	1,231	126	971	683
As a % of stockholders' equity (ROE)	**(12.8)**	53.5	12.6	5.1	15.9	1.9	15.8	12.5
Per common share	**(2.04)**	7.31	1.31	0.38	0.88	0.09	0.71	0.51
Net income (loss)	**(2,604)**	9,602	1,799	6,053	2,602	(268)	1,143	964
Per common share	**(2.04)**	7.31	1.31	4.20	1.86	(0.20)	0.84	0.72
Dividend paid per common share (from prior-year profit distribution)	**0.36**	0.30	0.25	0.23	0.18	0.18	0.14	0.06

* 1997 and prior years have been restated to reflect the sale of PolyGram N.V. in 1998 and to present the Philips Group accounts on a continuing basis.

Definitions

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

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

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

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

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

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

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

Capital employed

	2001	2000	1999	1998	1997	1996	1995	1994
Cash and cash equivalents	**890**	1,089	2,331	6,553	1,397	785	932	940
Securities	**130**	111	1,523	–	–	–	–	–
Receivables	**6,154**	6,806	6,453	5,442	5,464	5,369	4,890	4,567
Inventories	**4,290**	5,279	4,566	4,274	4,522	4,334	5,083	4,330
Current assets	**11,464**	13,285	14,873	16,269	11,383	10,488	10,905	9,837
Non-current financial assets	**8,421**	9,075	2,431	2,836	1,451	1,618	1,358	1,257
Net assets discontinued operations	**–**	–	–	–	1,482	1,198	1,013	901
Non-current receivables	**3,582**	2,713	2,326	1,920	1,858	1,662	1,413	1,397
Property, plant and equipment (book value)	**7,718**	9,041	7,332	6,574	6,935	6,719	6,094	5,599
Intangible assets (book value)	**7,269**	4,427	2,822	554	213	222	198	105
Non-current assets	**26,990**	25,256	14,911	11,884	11,939	11,419	10,076	9,259
Total assets	**38,454**	38,541	29,784	28,153	23,322	21,907	20,981	19,096
Property, plant and equipment:								
Capital expenditures for the year	**2,143**	3,170	1,662	1,634	1,627	2,185	2,127	1,535
Depreciation for the year	**1,969**	1,789	1,548	1,615	1,492	1,437	1,218	1,270
Capital expenditures : depreciation	**1.1**	1.8	1.1	1.0	1.1	1.5	1.7	1.2
Inventories as a % of sales	**13.3**	13.9	14.5	14.0	15.2	16.0	20.1	18.2
Outstanding trade receivables, in months' sales	**1.5**	1.5	1.4	1.3	1.3	1.3	1.5	1.5

Financial structure

	2001	2000	1999	1998	1997	1996	1995	1994
Other current liabilities	**8,193**	8,818	8,262	6,779	6,328	5,768	5,643	5,373
Debt	**7,866**	4,027	3,314	3,587	4,030	5,855	4,756	3,875
Provisions	**3,740**	3,491	3,118	2,985	3,251	3,420	3,460	3,566
Total provisions and liabilities	**19,799**	16,336	14,694	13,351	13,609	15,043	13,859	12,814
Issued, paid-up capital	**263**	263	339	1,672	1,655	1,600	1,566	1,536
Surplus and reserves	**18,190**	21,473	14,418	12,888	7,499	4,985	5,060	4,410
Stockholders' equity	**18,453**	21,736	14,757	14,560	9,154	6,585	6,626	5,946
Minority interests	**202**	469	333	242	559	279	496	336
Group equity	**18,655**	22,205	15,090	14,802	9,713	6,864	7,122	6,282
Total equity and liabilities	**38,454**	38,541	29,784	28,153	23,322	21,907	20,981	19,096
Net debt : group equity ratio	**27:73**	12:88	6:94	*	21:79	42:58	35:65	32:68
Stockholders' equity per common share	**14.48**	16.93	11.08	10.09	6.39	4.74	4.85	4.41
Market price per common share at year-end	**33.38**	39.02	33.75	14.30	13.80	7.94	6.58	5.83

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

Some key financial information in NLG and USD

all amounts in millions of Dutch guilders and US dollars unless otherwise stated

Philips' consolidated financial data are presented in euros. For the convenience of the reader, certain information is summarized below in Dutch guilders and in US dollars. The 2001 euro amounts of the statement of income and cash flow items have been converted at average rates, while the balance sheet amounts have been converted at the official rates as of December 31, 2001. The conversion rates used have been listed in the table below.

Statement of income	NLG		USD	
	2001	2000	**2001**	2000
Sales	**71,266**	83,437	**28,835**	34,864
Income (loss) from operations	**(3,021)**	9,434	**(1,222)**	3,942
Financial income and expenses	**(2,017)**	4,381	**(816)**	1,831
Income (loss) before taxes	**(5,038)**	13,815	**(2,038)**	5,773
Income taxes	**928**	(1,256)	**375**	(525)
Income (loss) after taxes	**(4,110)**	12,559	**(1,663)**	5,248
Results relating to unconsolidated companies	**(1,661)**	8,749	**(672)**	3,656
Minority interests	**33**	(148)	**13**	(62)
Income (loss) from continuing operations	**(5,738)**	21,160	**(2,322)**	8,842
Per common share	**(4.50)**	16.11	**(1.82)**	6.73
Net income (loss)	**(5,738)**	21,160	**(2,322)**	8,842
Per common share	**(4.50)**	16.11	**(1.82)**	6.73
Balance sheet as of December 31				
Cash and cash equivalents	**1,961**	2,400	**786**	1,014
Securities	**286**	245	**115**	103
Receivables	**13,562**	14,998	**5,433**	6,337
Inventories	**9,454**	11,633	**3,788**	4,915
Non-current assets	**59,478**	55,657	**23,830**	23,516
Total assets	**84,741**	84,933	**33,952**	35,885
Other current liabilities	**18,055**	19,432	**7,234**	8,210
Debt	**17,334**	8,874	**6,945**	3,750
Provisions	**8,242**	7,693	**3,302**	3,250
Total provisions and liabilities	**43,631**	35,999	**17,481**	15,210
Stockholders' equity	**40,665**	47,900	**16,293**	20,238
Minority interests	**445**	1,034	**178**	437
Group equity	**41,110**	48,934	**16,471**	20,675
Total equity and liabilities	**84,741**	84,933	**33,952**	35,885
Stockholders' equity per common share	**31.91**	37.31	**12.78**	15.76
Cash flow statement				
Net cash provided by operating activities	**2,750**	6,602	**1,113**	2,759
Net cash used for investing activities	**(10,058)**	(5,298)	**(4,070)**	(2,214)
Net cash provided by (used for) financing activities	**6,962**	(4,491)	**2,517**	(1,877)
Conversion rates in euros:				
Average	**0.45378**	0.45378	**1.1215**	1.0860
Year-end	**0.45378**	0.45378	**1.1326**	1.0740

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