

FINAL TRANSCRIPT

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PHG - Q1 2007 Royal Philips Electronics Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Royal Philips Electronics first quarter results 2007 conference call on Monday, April 16, 2007. Throughout today's recorded presentation, all participants will be in a listen only mode. After the presentation, there will be an opportunity to ask questions. [OPERATOR INSTRUCTIONS].

Please note that this call will be recorded and is available by webcast on the website of Royal Philips Electronics. I would now like to hand the conference over to Mr. Pierre-Jean Sivignon. Please go ahead, sir.

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Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Good morning, ladies and gentlemen. Let me first welcome you to this conference call for the first quarter results of 2007 for Royal Philips Electronics. I will make a few introduction remarks and then we will open up the call for your questions.

The first quarter was another successful step towards achieving many objectives which were designed to raise our profitability. Let me be more specific. The EBITA in the quarter was EUR353 million, or 5.9% of sales, and this compares to 4.5% a year ago. This increase is a good first step to achieving our target of above 7.5% for the full year 2007.

The comparable sales growth for the company was 3% with an average of 7% for the three divisions to which we will be reallocating more capital. DAP was 17% and Lighting was 8%. These growth levels support our annual average target of 5 to 6%.

In Medical Systems, the comparable growth was 3% with strong performances in MR, Cardiac Care and General X-Ray, with declines in CT and MedQuist. Equipment order intake showed a minimal decline compared to one year ago, mainly due to a softening of the US market. The EBITA increased in the quarter compared to one year ago after allowing for MedQuist and Intermagnetics related charges.

In DAP, the excellent quarter has given us a 17% comparable growth which, again, more than supports our target of 7% which we expect to exceed this year. The very strong growth came in virtually all product groups and geographical regions. Looking at it another way, we can see four main drivers this quarter. Firstly, the healthy living scheme, secondly, product innovation, thirdly, emerging markets, and, fourthly, a much higher level of sell-through than normal in the Christmas period, which gave us a flying start to the year. EBITA benefited from the affects of scale and good initial progress with the cost synergies at AVENT.

Sales in Consumer Electronics on a comparable basis declined by 6%. The main reasons for this are threefold. Firstly, lower mobile phone sales, which were influenced by the planned sale of the activity, which has now been completed. Secondly, our focus on margin management meaning the rejection of orders where the margin were just too low. And thirdly, last year was positively impacted by sell-in prior to the World Cup.

On a product basis, the continuing growth of Flat TV, which increased in quantities by over 50%, was offset by declines in CRT television and in monitors. On a geographical basis, there were declines in the United States and Latin America, particularly the CRT TV market in Brazil. It's important to note that the European sales in Consumer Electronics of Flat TV are driven by US\$ denominated supply. The downward impact of this is not fully reflected in the Q1 comparable sales of consumer electronics. The EBITA margin at 1.5% was a little higher than we expected.

The Lighting sales growth was 8%, driven by luminaires specifically and lamps, where there is high demand for energy efficient lamps. We expect this trend to continue and we expect to exceed our annual sales growth target of 6%. The Lighting EBITA was slightly lower than the first quarter of 2006 due mainly to LCD backlighting exit-related costs, and restructuring charges.

The results for Innovation & Emerging Businesses was in line with our expectations although slightly lower than one year ago. This was entirely due to a gain on an activity in the first quarter of 2006.

In Group Management & Services, we see the first impact of our cost reduction plan but I must point out that Q1 is seasonally a low quarter for expenditures. Pension costs were lower than we expected, we will continue with our brand investment in 2007, and the amount will be slightly less than the one incurred in 2006. We will complete our EUR 75 million cost reduction program this year.

The net cash in the quarter was EUR2 billion compared to EUR2.2 billion at the end of the fourth quarter of '06. This change was due to a number of factors, including the seasonally higher working capital.

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The inventory percentage of 11.6% is 30 basis points lower than one year ago. The main area of improvement was Consumer Electronics, where the inventory was significantly reduced. There continued to be one or two areas where the inventory to sales ratio can be improved and we are working on those areas.

The results from non-consolidated companies reflects the lower results of LG Philips LCD.

Based on ongoing discussions with various parties in the Netherlands, we remain positive that the second trading line will allow us to complete the remainder of the current buy back program during this year, which amounts to slightly above EUR1.6 billion.

We continue to look for acquisitions in the area that we have designated that will add value in line with our guiding principles.

I reiterate our intention to have leverage on our balance sheet within two to three years consistent with our rating objectives. We once again confirm our sales growth targets of an annual average comparable growth of 5 to 6% and an EBITA margin of above 7.5%. However, DAP and Lighting are expected to exceed their growth targets for the year.

Let me now open the call for your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. [OPERATOR INSTRUCTIONS].

Thank you. Our first question comes from Mr. Simon Smith. Please state your name, company name, followed by your question.

Simon Smith - Citigroup - Analyst

Hi. It's Simon Smith from Citigroup. The first question I had was on the Medical business. Obviously it was relative to expectation, a bit of a disappointing quarter for Medical. And I can see within there the additional charges of MedQuist, which it would seem relate to more of a one-off nature. But even allowing for that the EBITA margin you would have achieved say on an underlying basis there, of 8.3 is sort of slightly at odds with your guidance range of sort of 14 to 15 for the year. I wonder if you'd give us some color as to what's been going on within the division? And maybe particularly give us a little bit more color on the impacts you're seeing on the US through changes in regulation which were alluded to also by GE and how you see that panning out through the year?

Also, within the Medical division, I wondered if you could give us some sort of feel as to what we would expect for the full year in terms of amortization [charge]? So obviously, the differing -- or as you defined it, the differential between EBIT and EBITA?

My sort of second question really comes on to balance sheet structure. And in your AGM statement of a few weeks ago you did allude to the fact that you were actively looking at the balance sheet. Well, you've stated the fact you have a share buy back out there of EUR1.6 billion, you will be completing that this year. You have talked about the acquisitions, which we know you will continue to make. I just wondered what else could be the outcome of that actively looking at the balance sheet and whether you could give me some more color upon it? Thank you.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Okay. First, let's talk about Medical. I think if you look at the results of Medical in EBITA terms then I think that's what we should be looking at because, clearly, we basically now try to guide you on this. I have no problem to comment on EBIT but, as a rule,

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I will try to go to EBITA in order to start the process. But you have full disclosure on EBIT and certainly you are capable to read through the EBIT numbers as well but let's try to comment on EBITA.

So, the EBITA of Medical is actually, on consensus, pretty much but you are correct, we did have some incidentals. One is Intermagnetics, which added up with a partial accounting impact and integration costs which were higher than -- a little bit higher than the guidance. Actually, 8 million of that impacted the EBITA. Why is it higher, the value of the guidance? Because, as you know, some of those elements you only know once they have been actually evaluated by third parties. So we only got those news in the course of Q1 and we disclose the information as we actually have it. So there is EUR8 million in terms of EBITA which is coming from there

You alluded to MedQuist as well. Actually, in the particular case of MedQuist a couple of things basically which happened there. One was the fact that there was a settlement on the class actions with shareholders. There was some disclosure done by MedQuist themselves a couple of weeks ago and you have full details in that extremely explicit press release. So that has cost us some money there and -- but that's good news because that is something which was actually certainly have an impact on the future of MedQuist. And the other thing in MedQuist is that, as you know, we are working hard in getting the accounts current. A lot of audit work has been done on that back and some one-off entries were booked as well in this particular quarter. So all that is actually included in the particular list of one-offs that you have referred to.

If you exclude those two elements then, to your point is the margin of Medical for the first quarter too low? I wouldn't say, no it isn't. I think, historically, the margin of Medical is pretty much in that ballpark. If you look at last year we were in those numbers. Last year was a bit shy, you could say, but on the other hand, this year included a few incidentals. So I think that in terms of our guidance of a 14 to 15% EBITA for the year, absolutely no change there. I think, all-in-all, that's what I could say on the margin.

On the orders, yes, you have referred to the fact that GE came up with some numbers on Friday talking about no growth. Actually they came up, if I understand correctly, flat revenue. We are up 3%. It is true. I don't want to comment too much on GE. I can talk about us. In our particular case, in the orders we had for equipment, and that is equipment only, we had orders a touch negative essentially because of the US, some of it being due indeed to the Budget Deficit Act. But we believe that, thanks to the fact that we will have innovation in the latter part of the year as well as the fact that we are global, we are not changing our guidance there for the year. So I can't comment too much on the GE numbers but I can say that we are not changing our own numbers.

The only thing I would say between modalities is that in that first quarter there was one modality which was definitely a little bit slower than the rest, which was the CT. I think that's probably the one point I can emphasize.

To your question now on the difference between the EBIT and EBITA, I think the full difference for the year should be in the region of EUR150 million. I think that's the kind of number. You have now a chart, I think in the appendices of our press release, which guides you on the difference between EBIT and EBITA but, for the year, for Medical, it should be in that ballpark.

Your last question was related to the balance sheet. You are totally correct. First of all, I want to say that we confirm that, as I just said in the introduction, that we are confident that the EUR1.6 billion buy back line will be met. We've worked actively on getting that line to function and the transaction restarted in the latter part of last year and we believe that it will continue early this week. So we are confident that this line will function. We have been working on this and are absolutely confident.

In terms of the ultimate balance sheet structure of Philips, we are fully aware that we are not efficient. We will put leverage in place. We've guided you on the criteria we would like to use. We've talked about A minus down to BBB plus for a large, potentially large acquisition with good cash flows. In case of an acquisition like this we would be prepared to go down to that level, accordingly putting in place leverage within a maximum of two to three years. I think that's what we've said loud and clear at the general shareholder meeting a couple of weeks ago.

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In terms of avenues for [as far as the] avenues are known, the share buyback we've increased the dividends quite recently and, of course, we continue to look at acquisition in the particular domains that we have outlined.

Simon Smith - Citigroup - Analyst

Thank you, and just a point of clarification. When you are talking about the 14 to 15 range, that will be what you would expect to be your actual reported rather than underlying, say, excluding MedQuist or excluding the EUR8 million?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

No, no, no. It's absolutely it's the actual reporting EBITA?

Simon Smith - Citigroup - Analyst

Yes.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

For the year, yes absolutely, yes.

Simon Smith - Citigroup - Analyst

Thank you.

Operator

Thanks. The next question comes from Mr. Andreas Willi. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Andreas Willi - JP Morgan - Analyst

Good morning. It's Andreas Willi from JP Morgan. I have two questions, please. The first one on DAP, if you could break down the spectacular sales growth you had there a little bit more into what was the market, and maybe also at what rate AVENT grew in the quarter.

And my follow-up question would be on Medical again, with the -- you're confident that you will hit the 6% sales growth for this year. Are you also confident that you will get in the orders to hit 6% growth next year?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Okay, well, I think on DAP I would love to split but actually DAP has grown, I would say, in every geographic area and it just about -- it's three particular product divisions, which means Appliances, Shaving & Beauty, and Healthcare & Wellness. So we've grown actually everywhere -- geographically everywhere and it's a mix of things, a) it's as we've said in the introduction, we finished the year extremely strongly and certainly the fact that we invested in selling expenses in the fourth quarter, that had an impact on the -- getting into the first quarter, that's one reason.

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Second, we've continuously introduced new products and the good news is that we'll continue to do that in the latter part of this year. And thirdly, I think which -- what is quite important, is that we've gained market share. I think that there are parts of the world where we've gained market share, certainly in particular in Shaving & Beauty and probably, as well, in Appliances, Appliances meaning cooking appliances. Cooking appliances was supported by a wave of healthy living that is supporting the kind of products we are promoting. There is a green wave in lighting and there is a wave of healthy living in -- which is helping appliances.

As far as AVENT is concerned, I don't have the figure on AVENT. What I can say on AVENT is that AVENT had a positive impact on the profitability because, if anything, the integration of AVENT in terms of synergy on the expenses in our own channels is probably actually better than we initially thought. So AVENT is introducing new products and is having a more positive than planned impact on the cost of the particular division. AVENT is in DAP. So, we told you in the conclusion we would hope that we'll exceed the 7% revenue guidance for the year, at least that's our hope at this point of the year with a 17% start in Q1.

On Medical, I think your question is, can we make or confirm the 6% growth and you're talking about revenue growth for the year with the 3% in Q1? And obviously I would say it's low or lower than planned orders in imaging equipment in that first quarter, the answer is yes. We confirm our 6% for two reasons, or for three reasons I should say. One is that we will have some innovation coming in the latter part of the year. Two, we believe that the orders in Q2 should be better, I think. And three, because we feel that the backlog we have as at the end of Q1 is strong enough to [enable us] to say that. So we stand by our 6% revenue guidance for the year at Medical.

Andreas Willi - JP Morgan - Analyst

I was more looking at whether you will get enough orders this year not to have to eat into your backlog in terms of growth continuing into '08 then?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Well, I think -- oh yes, well, it's too early to say. I think I can guide you for the -- the guidance of Medical 6% has been, in our vocabulary, a mid-term guidance. So as at today I'm not answering this in a way that we would plan to empty the backlog. And by the way, I don't think that it's something which is in our control. As you know, in the backlog of Medical you have actually products with a totally different kind of timing. You have short term products, or shorter term products probably in Cardiac and Ultrasound and you have much more longer term kind of backlog on Imaging, MR, CT and even X-Ray that is obviously longer term. And, of course, you have even longer term on services. So I think emptying the backlog in order to meet a particular objective for a particular year, I don't think that is something which we can really control ourselves.

Operator

Thanks. The next question comes from Mr. Nicolas Gaudois. Please state your name, company name, followed by your question. Please ask a maximum of one question with one follow-up.

Nicolas Gaudois - Deutsche Bank - Analyst

Yes, Nicolas Gaudois, Deutsche Bank. Hi there Pierre-Jean. First question, coming back to Medical, could you maybe give us a bit of [clarity] on the drivers you would see in a recovery in Q2, as you mentioned for orders? And within that I'm also particularly interested in CT, if and when we will have a new platform released this year which could effectively reinvigorate sales?

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Second question, again with the share buyback, if I look on your website you seem to have done on the second trading line one transaction March 7 for 100,000 shares, yet you seem confident that you can achieve 1.63 billion program this year, so could you help us understand a bit more where this confidence is coming from? Thank you.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes, absolutely. Good morning, Nicolas. So yes, on Medical improvement, let me answer at two levels. I think on the CT, because you mentioned CT, actually the market has to digest, of course, the 64 slices, which is a regular, I would say, workhorse on this particular market. When a new platform will come? Well, you know the kind of product we are talking about. It's a bit early to say. I wouldn't disclose anything at this particular point, but everybody, and I think the market knows that new products are coming, more sophisticated certainly [inaudible] to come.

Could it be a reason for the slowing down on CT? It's a bit early to say but certainly today the market is focused on 64. The market knows that there is more product to come and the market certainly has to digest probably to some extent the huge introduction of new technologies which has been a characteristic of this particular modality in the last couple of years.

Where do I see improvement in Q2? Hopefully I will on CT. I think that's certainly something where we're expecting some progress. MR is a territory where we would expect some progress, as well. As you know, we are going to see the impact of the first quarter including the benefit of having Internagnetics part of the family. So I would expect on those two particular ones that we'll see some improvement in the second quarter versus the first quarter in terms of incoming orders for Medical.

As far as share buyback is concerned, you are absolutely correct. We did a transaction in the latter part of last week, so you are correct. You will see that we expect the pace of buyback to re-accelerate. Why that confidence? It's because, as you know, we've been constantly discussing and helping shareholders who are interested in selling, in getting comfort from the various competent authorities and we believe that we've made some progress in that particular domain last week. So, we are confident that the 1.6 plus on that particular line will be achieved this year.

Nicolas Gaudois - *Deutsche Bank - Analyst*

Thank you very much.

Operator

Thanks, the next question comes from Mr. Jonathan Crossfield, please state your name, company name followed by your question. Please ask one question which is the maximum and one follow-up.

Jonathan Crossfield - *Merrill Lynch - Analyst*

Yes good morning it's Jonathan Crossfield at Merrill Lynch. My first question's on DAP where margins are currently running ahead of expectations and you're exceeding your growth targets. I think in the past you've indicated that the division might sacrifice some margin to achieve higher growth. So could you give us a feel for what's going to bring the margins back down towards your guidance levels?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

That's a dangerous question isn't it. Well, I think we've always -- we've seen DAP -- 17% I have to admit is a very strong quarter. I have to say and I have to admit that's probably a bit north of what we were expecting. We knew DAP would be strong because you remember Q4, Q4 was very strong, and what is happening is that definitely for instance in Shaving & Beauty, the absolutely

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confirmed success of the new shaving line, which was introduced now a year and a half ago, is still showing and I think that is something that clearly is continuing to help us.

We did show some discipline in the model actually last year in Q4, we could have gone indeed for higher margin. We basically accepted to have lower margin on the back of increased selling expenses and obviously the result comes with a growth which is actually above what we expected and certainly what you expected. So for the model of this year would we want to modify that model? Probably not, I think the 15 to 16 is something we would like to stick to. Could we be slightly north of that? Maybe. Could we be north of the guidance on the revenue? Probably. Do we want to modify the model? No. Why is it that it doesn't go up? Well the answer is, we'll continue to invest in innovation, you will see a lot of new products at DAP. In the latter part of this year you will see new products certainly in Shaving & Beauty, you'll see new products in Oral Healthcare. Those introductions are definitely costing money but on the back of that there is a chance you'll see more growth and of course we'll continue to invest in selling expenses.

Are we prepared to modify or to announce a modification of the model of that? No, I think it's too early to say. You know that [all year] at DAP, as in all our consumer businesses, we've gone away from cyclicity but we still have strong seasonality and I think it's probably too early to say more than what we've currently disclosed to you in terms of guidance on DAP.

Jonathan Crossfield - *Merrill Lynch - Analyst*

Okay and then just as a quick follow-up on Lighting. Could you just give us a feel for what proportion of your Lighting sales are now energy efficient and what you expect the impact of the push towards energy efficiency could be in terms of CapEx?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes that's -- well this is actually an excellent question. Believe me I have worked the whole weekend to try to come up with the percentage because I knew this question would come up. But when you go through the details of the growth of Lighting actually almost all the businesses of Lighting with the exception of one have increased actually in this first quarter.

The next question is, what is the portion in each of these businesses which you could call green lighting? And the answer is, it's difficult to say because in each of those particular segments of Lighting we have energy efficient products. So unfortunately I am a little bit at -- in difficulty to give you a percentage because in reality all the business units of Lighting are actually growing. The one thing I could tell you is, all-in-all what you could call green products have probably grown at a rate of twice the overall growth rate of Lighting. So the one information I am prepared to disclose to you is probably that the so-called green products have grown at probably something like in excess of 15%.

Now for the quarters to come because we realize that for you it's quite important, we are trying to come up with the definition of what we could call green products in lighting so that we can give you a better guidance on this. But as at this particular quarter unfortunately I can't beside telling you all what I have already given to you in terms of details on Lighting.

Jonathan Crossfield - *Merrill Lynch - Analyst*

Okay thank you very much Pierre-Jean.

Operator

Thanks, the next question comes from Mr. Simon Schafer. Please state your company name, name followed by your question. Please ask one question with a maximum of one follow-up.

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Simon Schafer - *Goldman Sachs - Analyst*

Morning Pierre-Jean, it's Simon Schafer with Goldman. I actually had a question -- a follow-up question and it was very helpful to hear the amount of leverage would probably take your debt rating down to a BBB plus, somewhere in that range. I was wondering whether you could perhaps share some targets, what that would mean in terms of net debt to equity or net debt to EBITDA or some type of metric we could look at to get a better feel of what that could mean?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes it's hard to do that. I tried to do that in the past if you remember a year and a half ago we were guiding you with the particular leverage. I have to say I have gone away a little bit from that for one, not because I don't want to guide you, it's because I've had very lengthy conversation with rating agencies and I realize that in reality what is counting for them now, it's much more the sustainability of cash flow. So if that is really important for you I can give one more attempt at trying to do some simulation on leverage and come back to you on that.

At this point of time I prefer to [stay] a little bit away from that because, as I said, it's not totally clear to model that in a precise manner, and by the way the two rating agencies S&P and Moody's do not totally agree on that to be totally specific. But I can -- if you insist on it I'll try, I'll sit down with Alain and I'll try to translate that in something a little bit more factual than that rating guidance that we've given to you. I'll come back to you on that if really that is important for your - for the modeling of your projections.

Simon Schafer - *Goldman Sachs - Analyst*

Great, yes, thank you that would be very helpful I think. And then secondly, the biggest acquisition you've made to date kind of in the last number of years has been roughly a EUR1 billion for Intermagnetics and I thought it was helpful to see a slide just on the criteria that you're now -- you're looking at in terms of when looking at acquisitions. But is EUR1 billion the top of threshold that we're looking at or just in light of the capital structure now and in the light of what's going on at TSMC are we looking at potentially larger deals than that?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Well you are correct, Intermagnetics was the largest in the recent past, I think the second largest being Lumileds in the middle of 2005. Is that the biggest we will do? We could do bigger but the two questions I'm always uncomfortable to answer is, what is the portion of your reallocation of capital you will give to acquisition? I don't like answering this because I hate to say that we have a budget to acquire.

And the second question is, what is the size of what you're looking at? Because every project has to make sense on its merits and to a large extent regardless of its size, when we look at the projects it has to make sense in terms of numbers but it does have to make sense as well in our capability to digest it, do we have the management to [swallow] it and do the real criteria which we look at, could it be more than EUR1 billion? Yes. Do we have a chance that it's going to be a very, very large multibillion north of five? The chances of doing that are less than something which is south of five.

I think that's the best guidance I can give to you. It's very hard to be much more specific. The one thing I can add is that you can always judge a company on what they have done in the past and I think the track record of what we've done in terms of discipline, size, capability to integrate, there are indications at least of what has been our inclination so far.

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Simon Schafer - *Goldman Sachs - Analyst*

Absolutely, thank you very much.

Operator

Thank you. Our next questions comes from Mr. Didier Scemama, please state your name, company name followed by your question. Please ask one question with a maximum of one follow-up.

Didier Scemama - *ABN Amro - Analyst*

Hi it's Didier Scemama from ABN Amro. Thanks for taking my questions. I would just like to go back to the Medical margins. One of the things that you mentioned obviously about the growth rate at 6%, that's ex-currencies, but can we talk about the cost side because you were impacted to a certain degree in the first quarter by the euro dollar? However, we haven't seen that in the margins and I would suspect a fair amount of your costs are in dollars. So with the spot at 135 and a year-to-date average of 131 or 132, would you see the margins [straining] up more on the -- due to the cost than the revenue growth?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes good morning Didier, actually three answers. First of all on the cost. The cost base of the Medical, if you remember in the latter part of Q4 we indicated to you that we would take some extra cost to trim down or [inaudible] the organization, you probably remember that. So those costs are actually -- we have not disclosed them because we think it's part of our regular expenses. So those costs though are included in our Q1 numbers and they will certainly come with some mileage in the coming quarters because we have reduced our selling expenses in North America.

To your second question on the impact of exchange rates, if you look back at the structure costs and -- in terms of currency and the revenue base in terms of currency of Medical you will see that at Philips it's pretty -- we have a pretty natural hedge because not all our factories are in North America. We have factories, as you know, in Europe. We have a joint venture now in Asia and I would say that in terms of currency mix we probably have a rather balanced edge between revenue and cost across Medical. The one thing which certainly will help us gradually in the quarters to come is the increased supply coming from Asia.

There I would say there will be certainly some help in the cost. And the other thing which basically will continue to help us will be the leveraging of our selling organization. You remember that early last year we invested in our selling expenses in particular in Asia and those costs are now going to be considered as fixed and we should be able to leverage that.

One more thing on exchange rates, the one thing though you could say, which still could impact us in Medical is a translation exposure. Because, of course, when you translate back into euro the earnings which are generated in dollars, there if anything, we could have a negative exposure. That probably is the only thing I could mention as far as impact of currency on the results of Medical.

Didier Scemama - *ABN Amro - Analyst*

Okay. I still struggle a bit to understand how you can grow 6% on the top line with the backlog down in Q1 and even if it goes up in Q2, can you explain why?

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Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Sure, sure. No, no, absolutely. First, a) there is the strength of our backlog today for -- because the backlog we are describing to you is the one, of course, on equipment. Second is the growth of the other businesses, in particular Services, Services had strong growth actually in the first quarter of this year that is helping us, as well. And thirdly, we expect the order income to actually be stronger in the second quarter of 2007. So those three elements together basically are the answer to your question on the 6% guidance for revenue this year.

Didier Scemama - *ABN Amro - Analyst*

Ex-currency, obviously?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Oh yes, oh no, no, Didier, always excluding currency and always excluding perimeter because, of course, if we were --

Didier Scemama - *ABN Amro - Analyst*

You don't control that, so ...

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes, we don't control that.

Didier Scemama - *ABN Amro - Analyst*

Just -- a follow-up would be on Group Management & Services, you said the EUR45 million was a bit better than expected and obviously it looks like your EUR280 million sort of guidance for the year is going to be beaten. So can you just give us an idea of maybe an adjusted number for the full year, if you can share that with us?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

I want to share the model. I think could we do better? We are - as you know, when we told you last year that we would work on that big pocket which was visible, we are doing it. So the guidance of the 50 basis points in terms of headquarter expenses absolutely stands. It's linked to the 75 million run rate reduction program which is well on its way, and we are confident that and we confirm that, I think we mentioned it in the press release.

As far as the brand is concerned, you know what we spent -- we know what we spent last year. We will be south of that this year. It's a bit early to say how much south but we will be south of that amount and we will gradually come down. That was in line with the guidance we gave to you in November during the meeting here in Amsterdam. And we guided you, the other thing which is coming down is the pension cost, and there we've guided you in the press release. So all-in-all, yes, it will come down. To say much more, I think let's say it's on a good trend and a trend we promised you late last year.

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Didier Scemama - *ABN Amro - Analyst*

Okay, maybe a final question would be, so do we see a new margin base for DAP in Q1 or do you think that -- I know you've explained that a bit already but it's a spectacular performance you had in Q1. So is that the new base for the business going forward and therefore the back half of the year should be also higher than last year?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Well, Didier, it would be easy to tell you yes. And it would be -- but I think we want to be disciplined. I think, a) we've been disciplined in that business and the value of DAP can come from two angles. It can come from its margin but it can come, as well, from its growth. And we believe that the value of DAP comes essentially from its growth at high margins. And the discipline of last year is precisely what is enabling us to grow at 17% in that first quarter. So we are saying that we are shooting for more growth than guided, that's now our objective. That is in the outlook of the press release. To say we want to change the guidance on the margin, it's too early to say. This is Q1, Didier, I think we want to be careful there. I think we've been disciplined there. That discipline has served us well. If there is good news to come, we'll give it to you. We'll be more than happy to give it to you, but at this point of time discipline, discipline and strong growth.

Operator

Thanks. The next question comes from Mr. Julian Mitchell. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Julian Mitchell - *Credit Suisse - Analyst*

Yes, thanks, Julian Mitchell from Credit Suisse. The main question would be just on Lighting, if you could talk a bit more about the restructuring and that you took about EUR34 million in charges in Q1, 20 more in Q2 coming. Could you just give a bit more detail about where that's taking place? How much will be left over in terms of the second half of the year and so on?

And the second one or follow-up, your selling costs year-on-year in Q1 were up about 130 basis points versus sales. I guess your sales growth as a whole will accelerate in the second half of the year so that will naturally come down but could you just provide a bit more detail on your selling cost ambitions across the different businesses?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Okay. To your first question on the restructuring, yes, we mentioned 30 plus. What is that 30 plus made of? It's actually made of three categories. One was the exit cost of LCD. We told you at the end of Q4 that the backlighting in television is definitely something which will take place but probably more with LED than with LCD. The good news that we'll be present there as well, but on LCD we basically are disengaging from this particular one. So there is costs related to that particular element.

The second thing was, we always have a little bit of restructuring at Lighting every quarter and that is impacting us, as well, in that first quarter. I think that's the regular restructuring we have. We have a large footprint, as you know, still in Lighting and we are continuously [trimming] it, and that's part of this particular thing we do. And the third element was the -- in those, I would say, one-offs, we have of course, the integration costs of PLI which are impacting the EBITA, as well, and that is playing a role. So those three categories are essentially the elements which are impacting the first quarter.

Now, for the second quarter we've mentioned EUR20 million and there it's all in, including essentially the ongoing restructuring, which is taking place in the various parts of Lighting. The one thing I want to say on Lighting to an earlier question about the margin of Lighting, please do not ignore the fact that last year was impacted by EUR11 million of real estate gain, right. So when

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you compare Lighting like-for-like, Lighting is clearly up like-for-like Q1 this year versus Q1 last year if you take that into consideration, as well.

On selling expenses, you are correct. The percentage is a bit higher and it has to do with a) the new acquisitions which are coming in, which have got higher selling expenses. That is something which we need to address. But the other thing which obviously is playing a big role is the mix. The activities with higher selling expenses are the ones which add the larger growth in that first quarter and that is namely Domestic Appliances, as well as Lighting, as well, those two elements played a role in the mix.

So I would expect for the year our selling expenses probably to go back down once the mix, I would say, re-establishes to something a bit more normal. What obviously played a role was the fact that was down 6% on CE, CE is by far the lowest percentage of selling expenses, and that played a role, as well. And we see bouncing back in the mix in the quarters to come that will help as well putting selling expenses at the whole of Philips back to something which would be more normal.

Julian Mitchell - *Credit Suisse - Analyst*

Okay, thanks.

Operator

Thanks. The next question comes from Mr. Janardan Menon. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Janardan Menon - *Dresdner Kleinwort Wasserstein - Analyst*

Yes. Thanks. It's Janardan Menon from Dresdner Kleinwort. Just going back to your top line target, which is 5 to 6%, which you were reiterating today as well on your outlook statement. I was just wondering, your Consumer Electronics, which is by far the largest part of your revenue mixes, is going well below -- is going minus 6% effectively year-on-year. And I was just wondering where you're deriving the confidence to reiterate the 5 to 6% top line growth target in the light of that even if you do hit the 6% growth in Medical? Is there something that you foresee in the Consumer Electronics area in the second half of the year which will help you get to the target?

And a short follow-up is just, can you give us what your order intake in Medical Services was for the quarter on a year-on-year basis?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Okay. Janardan, I think on the 5 to 6 for the year, where do we get the confidence? First of all, CE, on this particular quarter, the minus 6, if you exclude phones, which was disclosed as -- you had a separate press release giving you the details of the phone transaction, the minus 6 is really minus 4. And moving forward, with the phones being deconsolidated, that will go away right from the negative comparison quarter-for-quarter.

Secondly, still on CE, if you look back at last year, CE had a stellar start to the year. Q1 of CE was up 16% in the first quarter of last year and the second quarter was strong as well on the back, of course, of the World Cup. And if you look back now at the latter part of the year, CE had a slower couple of quarters in Q3 and Q4 which will make, of course, the comparables in the latter part of the year much simpler. So that's the second part of the answer.

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Thirdly, on CE, there will be a new products introduction in the latter part of the year and we'll take confidence in these new product introduction. We believe that they will help us. And beyond television, by the way, the rest of CE, whether it is the home networks, whether it is peripheral and accessories, there we had actually businesses which grew in the first quarter and we take confidence from that.

And lastly, taking indeed Medical at 6%, we've guided you implicitly on basically the Lighting and DAP which should be, we expect, north of the guidance that we have given to you. So when you combine all that, basically we are confident on the 5 to 6.

Now, to your second question which is the incoming orders on Services. As you know, as a rule, we do not disclose our numbers on Services. We've not done it in the past. We don't want to start doing it. What I can tell you is that the incoming orders in Services were good. They were good this quarter. I think I can give you that information. They were strong.

Janardan Menon - *Dresdner Kleinwort Wasserstein - Analyst*

Okay. Thank you very much.

Operator

Thanks. The next question comes from Mr. Luc Mouzon. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Luc Mouzon - *Exane BNP Paribas - Analyst*

Yes. Hi. Good morning. It's Luc Mouzon from Exane BNP Paribas. Maybe a more general question on cash generation. Could you help us maybe to get a clearer view where Philips could land in term of cash from operation after the first quarter and, especially, would you expect further positive effect from working capital? I'm talking especially on other current assets which were a bit negative last year. Could we expect the Group to move, I would say, around EUR2 billion net free cash from operation? And I've got a brief follow-up. Thank you.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Well. I think we have worked, in terms of cash, you remember last year our fourth quarter was polluted by the impact of the sale of Semiconductor. We had a lot of moving parts in the fourth quarter, so we certainly plan to have a cash flow which is easier to read in that year 2007.

In terms of the elements of working capital, we disclosed to you that inventory had actually come down by a few basis points, largely driven by a drastic improvement at Consumer Electronics, which is quite important for us because it's essential that we enter the territory when you go with new products with actually inventory which are extremely low because that's when your new products comes up and you want to have very, very low inventory activity, which is exactly where we were at, at the end of Q1.

In terms of receivables, we had a good performance at receivable. Actually our [VSO] came down in Q1. I can tell you that. And payables as well were under control. To your EUR2 billion, no. I think that's too high. I think it's probably something like EUR1.5. I think it's probably a better number to look at. EUR2 billion free cash flow, no. I think that's as much guidance as I can give to you at this particular point.

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Luc Mouzon - Exane BNP Paribas - Analyst

Okay. And just the brief follow-up, regarding Emerging Businesses and what remains in terms of corporate investments, any chance that we're going to see further divestments to come this year? Relevant ones compared to the last announced?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Sorry, you talked about divestments in emerging markets?

Luc Mouzon - Exane BNP Paribas - Analyst

Yes, exactly. Divestments, disposals?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Oh sorry. In the Emerging Businesses line do we see more divestments? Yes. I think we said at the end of last year that we were down to less than 5. Actually, today, it's probably around 3. Are we going to see more divestments on that line? Yes. Our objective is to be totally done with that particular portfolio ideally mid-year and, at the very latest Q3, but the objective hasn't changed. Those -- that particular portfolio will be totally divested this year. No change there --

Luc Mouzon - Exane BNP Paribas - Analyst

Thank you.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

And it will take place.

Luc Mouzon - Exane BNP Paribas - Analyst

Thank you very much.

Operator

Thanks. The next question comes from Mr. Jan Berghuis. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Jan-Willem Berghuis - Kempen & Co - Analyst

Yes. Good morning. Jan-Willem Berghuis, Kempen & Co. I have a question on the Lighting division. You mentioned earlier that the 14 to 15% EBITA margin target for the full year was including, let's say, the MedQuist extra costs, how about the Lighting division? Your 12% EBITA margin target, is that including the EUR34 million and the EUR20 million costs you expect in Q2?

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Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes. I think the 12% EBITA guidance is all in. I think, as we normally do, we always try to guide you with all in targets so the 12% is all in absolutely for Medical -- excuse me, for Lighting.

Jan-Willem Berghuis - *Kempen & Co - Analyst*

Yes. Thank you very much.

Operator

Thanks. Thanks, the next question comes from Mr. Thomas Brenier. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Thomas Brenier - *Societe Generale - Analyst*

Yes. Good morning. Thomas Brenier of Societe Generale. A question on Lighting, just on a follow-up on what you were saying on their energy efficient products. Do you count all of Lumileds within that segment? And could you update us on the performance of Luminaire during the quarter in terms of sales growth and margin versus your initial expectations?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Okay. Can we describe Lumileds as a green product? I would say implicitly yes. I think Lumileds is a very high intensity light, as you know, with low consumption. So this is where I go back to the earlier question on this call, can I give you an overall mix of green products? It is difficult. We are working on that because this question is coming time after time. Could I say -- do I consider Lumileds to be green? I would say the vast majority of SSL, if not all solid state lighting should be considered as green.

As far as now the performance of Lumileds, the guidance for the year there is basically absolutely maintained with the 25% margin and 25% gross for the year. What is happening right now at Lumileds is that they are introducing a brand new product range, which is called Rebel, and we are expecting strong growth from that in the second quarter. So the guidance for Lumileds, no change. Is it part of the green? Yes. Are there new products coming at Lumileds? Yes and that will continue to be the case.

Thomas Brenier - *Societe Generale - Analyst*

Okay. And presumably, as it continues to grow faster than the rest of the division, should --?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes. No. Absolutely. Lumileds, historically, we've considered was adding almost a point I think of additional margin. So when we say Lighting grows at 6, last year we did 8 I think and there was almost a point on the back of Lumileds. And this year, certainly, we're guiding you on Lighting at 6 but Lumileds is at least a point in there. and if we can, as we have indicated, beat the six, certainly Lumileds will very much be part of it.

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Thomas Brenier - Societe Generale - Analyst

And going forward, let's say three, five years do we expect the margin of Lumileds to stay around these levels? Because that would mean basically that at some point it will start to have an impact, quite substantial on the margin of the whole division that --?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes, I think yes, I think we expect the margin of Lumileds to continue. The only condition to that is absolutely to continue to be the leaders and the undisputed, I would say, innovator in that particular category.

I think the reason why I mention this Rebel product introduction, which is another breakthrough is exactly illustrating that point, so will in the longer run, Lumileds stop having a positive impact on the overall margin of Lighting, yes. I think we guided you on a 12% EBITA for Lighting for the year and we said that there was some potential to be a bit north of that. I think that's what we said at the analysts' conference in September last year and we stand by that.

Thomas Brenier - Societe Generale - Analyst

You would think that you could be north of that already in '07 or is that more --?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

No I don't want to change the guidance. Same as for DAP, I think it's too early in the year. If we are capable of changing guidance we will. As you know, we've given you always as precise as we can. When we can we will. I think it's too early in the year to do that. It's only the end of Q1.

Thomas Brenier - Societe Generale - Analyst

Okay. A very, very short question on pensions. You say EUR25 million for the full year. Could you give us the exact amount for Q1?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

I think that Q1 was 7. I think I am told around that we have time for -- a few more questions, yes. Sorry, we can continue.

Operator

Thanks. The next question comes from Mr. Maurits Heldring. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

Maurits Heldring - Kepler Landsbanki - Analyst

Good morning, it's Maurits Heldring from Kepler Landsbanki. I just want to come back to the Lighting division and the impact of the growth of what you call green products. As you said the impact from Lumileds on the margin going forward will be beneficial but will that be the same also from the other green products? Maybe you could talk a bit about the, yes let's say, mid-term impact on the margin from this whole growth of green products? And maybe you could also indicate whether you expect any substantial uptake in capital expenditures in Lighting because of this trend?

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Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Okay, again I think, given the number of questions we have on green products, this absolutely confirms that we will come back with a specific definition because I want to be very specific and disciplined here and answer you on the back of a precise definition. That definition today of green products is not specific enough to elaborate too much. But if around this [phone] we say that green products is solid state Lighting and some of the technologies like compact, fluorescents or halogens and these kind of energy efficient technologies as well as luminaires which include those kind of technologies, let's describe green products as that for the time being.

Now to your question, are those products having an impact on the margin? Yes. Most of those products are high margins. Basically, the good news about green products is that not only they are green but on top of that they are consuming less energy, which means that for the buyers, whether those buyers are consumers or whether they are corporations, when they do their math, they are facing a product which consumes less energy and has a duration which is longer. So that enables these particular customers to pay value for money on the back of something which is interesting for them.

So are those products all-in-all having a positive impact on the margins of Lighting? Definitely yes. Luminaires for instance, is a professional luminaire is a business which drives a good margin for us.

Now to your questions on CapEx, we're not expecting a significant change in the pattern of the capital expenditure of Lighting. Actually, you look at the CapEx for this quarter, which is normalized, the CapEx of last year and I think we've disclosed that in previous press releases, includes a EUR71 million investment we have made in a building for Lumileds. At the time we acquired Lumileds last year we needed that building for manufacturing reasons. So that's why the CapEx of Lighting looked a little bit rich last year but I would say that the CapEx for this year is something which is much more in line with the kind of CapEx you should have for the year. So we're not expecting any big change of CapEx for Lighting for the quarters to come. So 58 was the CapEx for Q1, 52 was the depreciation and we don't expect any massive change in that kind of trend for Lighting.

Maurits Heldring - *Kepler Landsbanki - Analyst*

Okay, thank you.

Operator

Thanks, we have a follow-up question from Mr. Nicolas Gaudois. Please ask one question maximum.

Nicolas Gaudois - *Deutsche Bank - Analyst*

Yes, hi there. Just to clarify, on when you say you could do domestic appliances when you say you could do better than guidance, [is this for] thinking about the 6, 7% year-on-year growth for this year or should we have another number in mind? Thank you.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

No I think that the guidance for DAP was 7 for the revenue and when we say we could do better, it is to be north of 7. The guidance for Lighting was 6 and when we say we could do better, it's to be north of 6. Those are the specific numbers for this yearly guidance of revenue.

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Nicolas Gaudois - *Deutsche Bank - Analyst*

Perfect, thank you very much.

Operator

Thanks, we have a follow-up question from Mr. Didier Scemama. Please state at least one question.

Didier Scemama - *ABN Amro - Analyst*

Okay thanks for the question. Just going back to the DAP margins, it seems like you had a flow through to EBIT in the quarter of about 45%, so on the incremental revenues if you want. So I'm just wondering, what's the underlying reason for this extremely strong performance beyond what you've written in the press release, which is AVENT? I can't really imagine AVENT is the only reason there?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

No it isn't but AVENT -- no, the reason why we disclosed AVENT is because Q1 was a quarter where we could really integrate the channels of AVENT with the channels of DAP and we ended up, and that's why we disclosed it in a previous point. We ended up having more synergies on that particular point than what we had initially anticipated.

Now back to your question, why do we have such a strong performance at DAP? The answer is of course margin. I think when you are the leader in product category, when you come up with innovation, you can [price]. And the key driver for the improvement of the DAP was actually improvement of gross margins. And I think the expense and in particular, the selling expenses that's below the gross margin level and where that's part of our model, to continuously spend in order to have the right positioning, the right communication in the right product category at the right stores. But the key thing, the growth engine in terms of margin is in the gross margin. And that's where basically we did well in Q1.

Didier Scemama - *ABN Amro - Analyst*

When you say gross margin, did you have a specific impact from the consumable products?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

All categories. I think we've been fortunate in Q1. Cooking appliances did well. When we say appliances, as you know, we refer to cooking appliances. That did well. Shaving & Beauty did well. Basically all our product divisions and basically [OHC] Oral Healthcare, which I forget to mention, I mentioned it in terms of introduction of new products, all healthcare did very well. We are gaining share in all healthcare in the particular territories where we are present, as you know, UK, North America in particular.

Operator

Thank you. The last question for today comes from Mr. Marcel van der Hoef. Please state your name, company name, followed by your question. Please ask one question with a maximum of one follow-up.

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Marcel van der Hoef - *Bloomberg News - Media*

Yes, good morning, Marcel van der Hoef, Bloomberg News. I was wondering if you say you may exceed your targets for DAP and Lighting and you expect to reach your target for Medical, is it fair to say that the overall sales of the company will exceed targets or will CE be going down too much to do that?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

No, not at all. For the Group to go at 5 to 6, even in the particular scenarios you described for the other three, you need CE to do well. You know that on CE -- CE is 40% of the revenue. You know that on CE growth is not our objective because our objective is a business model with profit and CE has not been profitable consistently for the last three years and we are quite proud of that. It's actually a very unique model in the CE business and we take some pride of that. But CE will grow in 2007. And in order to make 5 to 6 for Philips we need CE to grow and CE will grow.

Marcel van der Hoef - *Bloomberg News - Media*

Okay, but if you say that the Lighting and DAP will exceed targets, could you say that the overall Group will grow more than 5 to 6%?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

No, I think it's too early to say. As you know, we've gone away from cyclicity, we've not got away from seasonality. We still have a very large chunk of the revenue of Philips which comes on the back of the fourth quarter. It's way too early to talk about that. No we are just reconfirming the 5 to 6, confirming guidance at all levels and I think it's too early to say much more at this particular point of time.

Marcel van der Hoef - *Bloomberg News - Media*

Okay, very last question. You say DAP was mainly driven by the gross margin. Could you say what the gross margin was in the quarter?

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

No, we don't disclose gross margins. I think I was answering the question from, I think Didier Scemama I believe, to explain why -- how does the [inaudible] works, it is gross margin driven clearly, which means that pricing is good but we don't disclose percentages of gross margin now.

Operator

Thank you sir. We have no further questions at this time, please continue.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Okay, if there is no more questions, we thank you for your time, thank you for your attention and we say you goodbye.

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Operator

Ladies and gentlemen, this concludes the Royal Philips Electronics first quarter results 2007 conference call. Thank you for participation g you may now disconnect.

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