

# The Philips Way

Our company was founded in Eindhoven, the Netherlands, in 1891 to “manufacture incandescent lamps and other electrical products.” Ever since then, we have been simplifying and enhancing people’s lives with a steady flow of pioneering innovations, for instance in the fields of medical imaging, television, lighting, optical technology and integrated circuits. Today, we remain committed to building upon this rich heritage to make people’s lives simpler, more enjoyable and more productive.

## Vision 2010

In 2001 we started out on a journey to transform Philips into a focused, market-driven company capable of delivering sustained profitable growth, and so creating value for our stakeholders. Over the course of the intervening years, we have fundamentally repositioned Philips from a rather volatile, technology-focused, vertically integrated electronics company to an applications-oriented, customer-centric and more predictable company. This involved a massive capital re-allocation, away from cyclical technology businesses and toward expansion of our high-margin core businesses through acquisitions, innovation and brand injections, as well as returning capital to shareholders through tax-efficient share buy-backs and dividends. In 2007 we took another major step forward with the announcement of our Vision 2010 strategic blueprint.

Vision 2010 places the customer at the very heart of everything we do. Accordingly, we have realigned our entire organization around the needs we see in the marketplace. Effective January 1, 2008, we now have three sectors – Healthcare, Lighting and Consumer Lifestyle.

## Insights and empowerment

Our mission is to improve the quality of people’s lives through the timely introduction of meaningful innovations. In a world where complexity grows to touch every aspect of our daily lives, we will lead in bringing sense and simplicity to people.

Based on a deep understanding of what people really need and want, and delivering on our promise of simplicity, we empower our customers – both healthcare and lighting professionals and end-consumers – with solutions that are advanced, yet designed around them and easy to experience. Specifically, we address these needs and desires in the four domains of *my space*, *my body*, *my appearance* and *my mind*.

As well as expressing a commitment to eliminate unnecessary complexity and to deliver the meaningful benefits of technology, our “sense and simplicity” brand promise also defines how we want to be seen by all our stakeholders – open and transparent, approachable, easy to do business with.

Today, Philips is a much simpler company focused on the market, centered around the brand and driven by innovation. We see tremendous potential in both mature and emerging markets and leverage our competencies in design, technology and marketing to capture value from some of the major economic, social and demographic trends, e.g. the growing demand for better healthcare at lower cost, consumer empowerment, the rise of emerging markets and the need for energy efficiency.

As we strive to enhance the quality of people's lives, our 7 strategic drivers are helping us become a simpler, stronger and greener company.

#### **Vision 2010 – ambition to significantly increase shareholder value**

- **Improve the EBITA margin of our current businesses to exceed 10%**  
Through improved margin management, increased contribution from recent acquisitions, a better product mix, the effects of the organizational simplification and reduced corporate brand spend.
- **Drive comparable sales growth at a minimum of 6% (compound annual sales growth) for the period 2008-2010**  
Fuelled by organic growth, and through a specific focus on emerging markets and developing economies.
- **Arrive at an efficient balance sheet by the end of 2009**  
Through a combination of further value-creating acquisitions and continued return of capital to shareholders.
- **Thanks to the combined effect of these measures, we expect EBITA per common share to more than double by 2010 from the 2007 level.**

#### **Management Agenda 2008**

As a result of a thorough review of our 2007 achievements and remaining challenges, as well as our expectations for the development of the global economy and the competitive environment, we have adopted the following management agenda for 2008:

- Integrate and leverage recent acquisitions, delivering the anticipated return on investment
- Take decisive steps to structurally deal with unsatisfactory EBITA margins at Connected Displays
- Improve productivity as a driver of margin expansion
- Step up resource investment in emerging markets to accelerate growth in excess of 2x GDP
- Increase innovation focus in support of Philips' growth ambition
- Continue to drive a culture of superior customer experience
- Bring employee engagement to high-performance benchmark

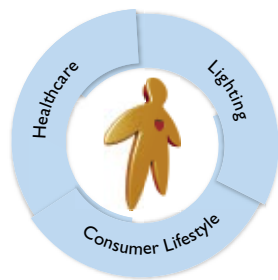


# Our 7 strategic drivers

## 1

**We are a people-centric company that organizes around customers and markets**

Vision 2010 positions Philips as a market-driven company with an organizational structure that reflects the needs of its customer base.



Our three new sectors, Healthcare, Lighting and Consumer Lifestyle, each address different markets, but have one thing in common – the customer is at the center.

By bringing together Medical Systems and our growing Home Healthcare Solutions business, for example, we can develop solutions that deliver value throughout the complete cycle of care – from disease prevention to screening and diagnosis to treatment, monitoring and health management.

And by combining CE and DAP, we will leverage our competencies to create competitive advantages in a challenging marketplace. Merging sales teams, for example, will create greater focus and reach within our chosen markets. Optimizing supply and service processes will improve customer-centric effectiveness. And combining consumer insights will enable us to deliver even more compelling value propositions.

## 2

**We invest in a strong brand and consistently deliver on our brand promise of “sense and simplicity” in our actions, products and services**

The 2007 wave of our brand campaign showcased a range of simplicity solutions that empower consumers, particularly families, to manage their health and wellbeing. These advertisements underscore the deep consumer knowledge and insights that set Philips apart in the healthcare industry.

By investing consistently in our brand – also through activities like our Simplicity Events – we are seeing its value increase significantly, as evidenced by our fourth successive rise in the annual Interbrand top 100.



## 3

**We deliver innovation by investing in world-class strengths in end-user insights, technology, design and superior supplier networks**



Technology continues to drive many of our innovations, and innovation is integral to everything we do. But to ensure it is relevant and meaningful, we take end-user insights as its starting point.

Product creation and development begins with an understanding of people’s needs and aspirations. We make extensive use of our Experience Labs, where we can study people interacting naturally with our product concepts. If they find the concepts too complex, we make them simpler or go on to the next innovation.

The Philips Wake-Up Light is a new, medically proven wake-up solution based on the simulation of dawn. It emits light that gradually increases to the intensity you have selected, gently preparing your body to wake up. This “dawn light” positively affects your energy hormones, enabling you to rise naturally and easily, feeling energized and refreshed.

# 4

We develop our people's leadership, talent and engagement and align ourselves with high-performance benchmarks

In the 2007 edition of our annual Employee Engagement Survey, almost 100,000 Philips employees – from across all sectors and functions – were invited to answer the same 39 questions on leadership, management capabilities, alignment with Philips' vision, identification with the brand, and reward recognition.

The Employee Engagement Index figure increased to 64%, from 61% in 2006. We have set ourselves the goal of reaching the high-performance norm of 70% by 2009. So while we are on the right track, the remaining gap still needs to be closed.



# 5

We invest in high growth and profitable businesses and emerging geographies to achieve market leadership positions



We are well positioned to benefit from major trends that will determine global GDP development in the coming decade, i.e. the need of a growing and longer-living population for more and affordable healthcare, the need for energy-efficient solutions (e.g. for lighting) and developments in the consumer space. We are also well placed to realize profitable growth in emerging markets, while contributing to the sustainable development of these economies. We continue to pursue opportunities to make value-creating acquisitions that can further our growth ambitions. The acquisitions we announced in 2007, for example, strengthened or established our leadership positions in promising markets, or gave us access to new markets. The successful integration of Partners in Lighting International, Color Kinetics and Genlyte will significantly boost our global leadership position in the market for advanced lighting solutions, while the announced acquisition of Respironics puts us firmly at the forefront of the fast-growing market for home healthcare solutions. Now, the priority is to successfully integrate and leverage these acquisitions in order to capture their full value and so deliver the anticipated growth and margins.

# 6

We are committed to sustainability and focus on making the difference in efficient energy use

Global climate change, rising energy costs and pressure to meet targets on reduction of CO<sub>2</sub> emissions are major issues facing the world today. Addressing these imperatives and the opportunities they present will have a major impact on global business.

Philips has a long-standing commitment to providing solutions that improve people's lives and are environmentally sound. Now we are the industry leader in energy-efficient lighting with, for example, our state-of-the-art TL5 lamps and LED light sources, electronic gear, high-efficiency optics and energy-saving lighting controls.

We are aiming for our Green Products to generate 30% of total revenues by 2012, compared with 15% of group sales in 2006. This commitment is part of our latest EcoVision program, which aims to double our investment in green innovations to EUR 1 billion in the next five years and increase the energy efficiency of our operations by 25%.

During 2007 we launched our Green Logo, a simple tool to help consumers find Philips' Green Products in stores and make responsible choices.



# 7

We drive operational excellence and quality to best-in-class levels, allowing us to make strategic investments in our businesses



Philips Business Excellence (PBE) provides a holistic framework for assessing an organization's position relative to world-class performance, identifying strengths as well as improvement opportunities that support business objectives.

In few areas are the demands for manufacturing excellence higher than in the automobile industry. This drives our Automotive Lighting business, which has adopted a zero-defects policy – not as a philosophy but as a hard target.

Using the Philips Business Excellence program, our people at Automotive Lighting identify what improvements are needed, and formalize them in the management agenda. The policy is based on management attention and shop floor focus. Black Belts (process experts) and Green Belts (operational and tactical experts) lead improvement teams focused on product quality issues. Our Lighting Quality Improvement Competition provides a platform where the teams can share their experiences and learn from each other, as well as motivating and engaging our people.

# Our sustainability focus

## Key global trends and issues

|   |
|---|
| <b>Societal</b>   |
| Growing population in developing world                          |
| Aging population in developed world                             |
| Instability/terrorism   |
| Emerging roles of industries and non-governmental organizations |
| Digital divide  |
| Privacy   |
| Rising attention on human rights                                |
| <b>Business / Economics</b>                                     |
| New and emerging markets  |
| Shift from West to East   |
| Off-shoring/outsourcing   |
| New business models   |
| New technologies  |
| Knowledge management  |
| IP (infringement, licensing and enforcement)                    |
| Business integrity  |
| Transparency/accountability                                     |
| <b>Health</b>   |
| Rising healthcare costs   |
| Lack of access to affordable healthcare                         |
| Infectious diseases in developing world                         |
| Chronic diseases developing world                               |
| Threat of epidemics (Bird Flu, SARS, etc.)                      |
| Employee health and safety                                      |
| Animal testing  |
| <b>Environment</b>  |
| Climate change  |
| Clean air and water   |
| Energy management   |
| Limited natural resources                                       |
| Take-back and recycling   |
| Use of chemical substances in products                          |
| Waste management  |

## Sustainability trends and relevant issues

We continuously look at the world around us to track key trends and material issues. We blend this outside-in perspective with internal analyses (including our company strategy and risk assessment processes) to determine the issues most relevant for our company and those where we can make a positive contribution to society at large.

We review trend analyses from a variety of sources, including the World Bank, World Business Council for Sustainable Development, World Economic Forum and World Health Organization, as well as our own research. As a member of organizations like the World Business Council for Sustainable Development and the Electronic Industry Code of Conduct, we participate in meetings and task forces, bringing new learning to bear. Our work also involves tracking topics of concern to governments, regulatory bodies and non-governmental organizations, and following the resulting media coverage.

## Stakeholder engagement

To gain additional outside perspective on sustainability trends and global issues, we engage our stakeholders in a variety of ways. We strengthened our approach to stakeholder engagement in 2007 with, among other activities, a series of Philips Forums and our first Sustainability Innovation Day event.

## Philips Forums

Our stakeholder outreach program includes genuine dialogue with small groups of opinion leaders and relevant stakeholders at a series of events we call Philips Forums. In 2007 we held sessions in Kuala Lumpur, Singapore, Tokyo and the United States, and we plan to conduct additional forums in 2008.

The purpose of the Philips HealthCare and EnergyCare Forums is to create an environment in which leading stakeholders and the company's top management can

engage in a two-way exchange of ideas and opinions on issues of mutual interest, social relevance and global importance.

Based on societal trends within the healthcare and energy sectors, the aim is to share expertise and co-create solutions that will make a difference to future generations.

**Sustainability Innovation Day**

We discussed projects we are exploring with key stakeholders at Sustainability Innovation Day at our Corporate Research Exhibition in May 2007. Originally launched in 1959 as an internal event intended to help researchers from different labs find synergies in their work, in 2001 Philips businesses began bringing strategic customers to the event and extending invitations to other key external stakeholders in the following years.

Among the guests on Sustainability Innovation Day were members of government, academia and non-governmental organizations. Inviting outside parties to

this event is an example of our Open Innovation model. We strongly believe that partnerships are a lot stronger than just doing things on our own. So outside feedback is very important to us. After seeing innovations we are exploring in healthcare and energy, attendees shared their insights and challenged the company to ensure that environmental and social issues are at the forefront of the innovation process.

**Key material issues**

To identify the key material issues we use the mapping approach shown below, which plots the material issues on a scale from low to high in terms of the:

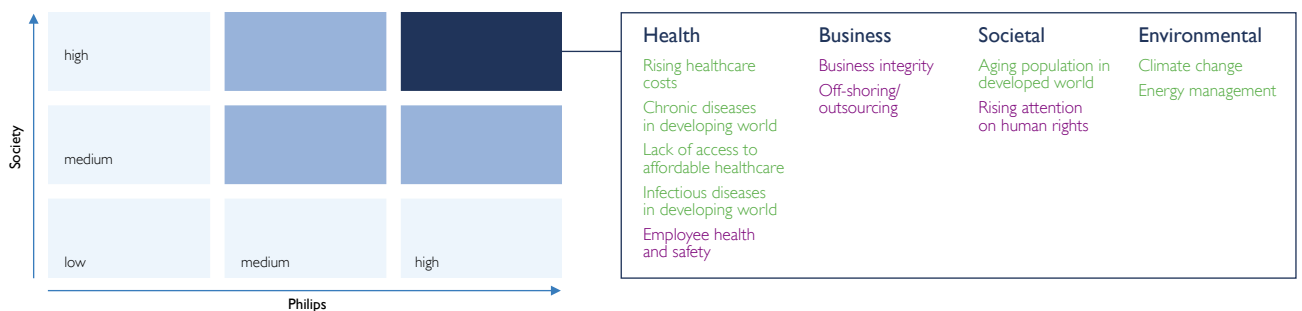
- level of concern to society and stakeholders, versus
- impact on Philips, or
- level of control or influence we can have on an issue through our operations and products/solutions.

The overview of material issues illustrated here includes both risks and opportunities. Our primary focus in this report is on business opportunities – to show how we can play a positive role in meeting the sustainability challenges we face globally.

**Materiality matrix**

The mapping approach

- These issues are classified as material, and are covered in this report
- Issues in these squares can become material and may be covered in future reporting
- Opportunities
- Risks



We also recognize that opportunity brings responsibility and requires managing risk. Detailed information on our General Business Principles, Supplier Sustainability Involvement Program, and our approach to risk management and control can be found in our online *Sustainability Report 2007* and our *Annual Report 2007*.

Based on global trends, stakeholder input and our company strengths, we develop our strategy and vision, as well as the programs and policies to drive the implementation of our strategy.

#### Our focus

We want to become the recognized leader in key Philips global market opportunities relevant to society at large, by applying our company strengths. As a result, we focus on energy efficiency and healthcare.

#### Healthcare

The area of healthcare is clearly of essential importance. Every human being should have access to affordable healthcare of decent quality. To achieve this goal will require a huge effort. As a result, healthcare will be a very important driver of economic development over the coming decades.

Businesses, government, insurers and healthcare institutions will have to work together to find innovative solutions. For example, we need to shift from costly treatment at a late stage of disease to prevention and early detection. Prevention can be increased by healthier lifestyles and a cleaner environment. Remote patient management can help us to bring healthcare to areas where traditional healthcare is not available. At Philips this means focusing on the full cycle of care, which is described beginning on page 46.

Our heritage of understanding how people react to technology, combined with our deep clinical knowledge, puts us in a unique position to address the challenges of contemporary healthcare systems.

The pursuit of personal wellbeing is a universal trend, equally relevant in both mature and emerging markets. Our focus is shifting from products to experiences or atmospheres that reinforce healthy lifestyles, as illustrated by our ambient experiences and our emphasis on entertainment and wellbeing in the home and beyond.

#### Energy efficiency

As for energy management, climate change is one of the most pressing issues of our time. At the same time, we know that energy resources, so necessary for development, are scarce.

Energy efficiency helps to address both challenges. As the number one lighting company in the world, Philips is taking the lead in the promotion of innovative, energy efficient lighting solutions in houses, streets, offices, shops and cars. And we are strengthening the energy efficient and Green Product approach at both Healthcare and Consumer Lifestyle, leveraging the experience of our Lighting sector. You can find full details beginning on page 26.

## EcoVision4

In 2007 we launched our latest environmental action program, EcoVision4.

We were at the forefront back in 1994 when we instituted a disciplined approach to environmental improvement with our first program, which set a series of measurable targets. At the same time, we introduced our EcoDesign process, which deals with all aspects of the product creation process. In 1998 we began our drive to develop Green Products. Since then we have continuously raised the bar with the ambitious goals of our subsequent programs, including EcoVision4.

### EcoVision4 targets

With EcoVision4, we have committed to:

- Generate 30% of total revenues from Green Products over the next five years (up from 15% in 2006);
- Double our investment in Green Innovations to EUR 1 billion by 2012; and
- Further increase the energy efficiency of our operations by 25% by 2012.

### Green Products

Philips Green Products offer customers, users and society a significant environmental improvement in one or more of the Philips Green Focal Areas:



We use the Life Cycle approach to determine a product's overall environmental improvement. The Life Cycle Assessment calculates the environmental impact of a product over its total life cycle (raw materials, manufacturing, product use and disposal). The result of such a calculation is an Eco-Indicator.

The score of a given product in a Green Focal Area is significantly better when it is 10% better compared to the reference product, which can be a competitor, predecessor or other product in the particular product family.

### Green Innovations

The need for Green Innovations is clear and we are working to ensure that we get the maximum results from our efforts to stimulate innovation. Corporate Technologies – which includes Corporate Research, Philips' Incubators, Intellectual Property & Standards, campuses in India and China, as well as Applied Technologies – feeds our innovation pipeline.

Our goal is to develop true breakthroughs that benefit society and create value for the company and our stakeholders. We will do that through our investment in Green Innovations, concentrating on our main areas of expertise.

We recognize that innovation is not limited to inventions brought about by basic research. Progress can also be driven by the development of original applications of technologies that already exist. One example is our energy efficient urban lighting solutions. In addition to Green benefits, these lighting architecture solutions improve safety, comfort and atmosphere.

We also know that we have to be flexible to truly maximize the value from our innovation efforts. Not every promising idea can be nurtured within the environment of our established businesses – sometimes because the idea is too much of a break-away, sometimes because the expected returns or scale up are too slow for our global businesses. We would be destroying value if we just left those technologies on the shelf. That's why we have set up three Incubators – to develop these technologies in

a separate, entrepreneurial environment that measures performance in terms of growth, not earnings.

After nurturing and developing these ideas for a few years, successful incubator initiatives make it into new businesses, often within Philips, but we have also spun out some of them as independent companies. Society at large profits, because promising technologies do not rust on the shelves and can be developed into new business. Philips profits, because the incubators allow us to extract more value from our R&D efforts.

#### Operational energy efficiency

To improve our operational energy efficiency, and reduce the associate CO<sub>2</sub> emissions, we needed a solid baseline from which to compare our improvement in the coming years. So during 2007 we worked to establish a clear view of our company's operational carbon footprint, applying the Greenhouse Gas Protocol. Developed by the World Business Council for Sustainable Development and the World Resources Institute with extensive review from stakeholders around the world, this is the most accepted standard to calculate greenhouse gas emissions.

#### Our operational carbon footprint

We focused particularly on those areas we can directly influence, for which we have set reduction targets.

Our operational carbon footprint includes:

- Direct emissions from our manufacturing processes and non-manufacturing facilities.
- Indirect emissions from purchased electricity.
- Other indirect emissions that we can influence directly: logistics and business travel.

Our operational footprint does not include, among others, the following elements of indirect impact:

- Production of purchased materials and outsourced manufacturing activities. However, we are starting to work with some of our key suppliers to improve their

operational energy efficiency. (Details are available in the section on "Our suppliers" in our online report.)

- The use of our products. By far the most significant impact on global warming is from the use of our products. Based upon preliminary estimates, the carbon footprint for use of our products is more than 300 million tons of CO<sub>2</sub> equivalents, most of which relates to lighting products. For perspective, our operational carbon footprint is less than 1% compared to the impact of the usage of our products. This is why we have sharpened our focus on Green Products and Green Innovations.

Additional details on how we calculated our operational carbon footprint can be found on pages 68-96.

Calculating our carbon footprint is a complex exercise. Not all source data are directly available, while other data have been measured for 10 years (in our manufacturing facilities, for example) and are highly reliable. Some data were incomplete and had to be extrapolated or converted from other source data or estimated. We will continue to work to further improve the data, using 2007 as a solid base for reporting our improvements through 2012.

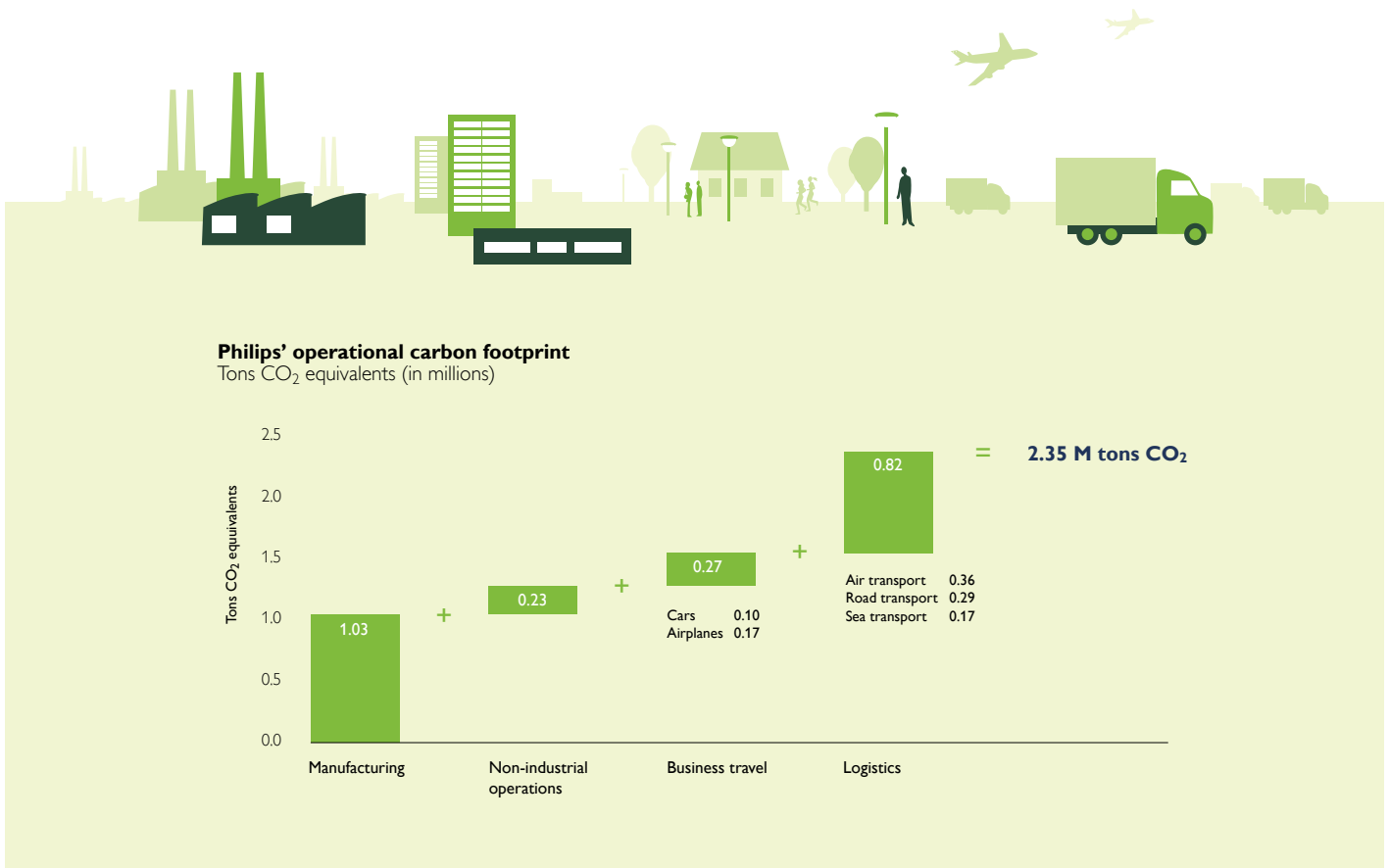
Based upon the available data, we calculated our total operational footprint to be approximately 2.35 million tons CO<sub>2</sub> equivalents.

For each area we have developed action programs to drive energy efficiency and associated CO<sub>2</sub> reductions.

#### Manufacturing

In manufacturing we have targets to improve energy efficiency as part of our EcoVision III (2005-2009) program. Currently we are expanding this to specific targets for each sector through 2012.

“We are committed to reduce our operational carbon footprint.”



**Non-industrial facilities**

For our non-industrial facilities (offices, warehouses, etc.) we are focusing on upgrading our lighting systems.

**Business travel**

We are strengthening our programs to reduce the impact of business travel, including videoconferencing, low carbon car rentals and Green car leasing. (See the section on “Our suppliers” in our online report.)

**Logistics**

Air transport accounts for the majority of the total CO<sub>2</sub> emissions related to logistics. We are putting programs in place to use the type of transportation that has the lowest CO<sub>2</sub> impact per kilometer. (Please see “Our suppliers” in our online report.)