

Vereniging van Effectenbezitters
Postbus 240, 2501 CE Den Haag
Bezoekadres: Amaliastraat 7, Den Haag

Tel.: +31 (0)70 313 00 00
Fax: +31 (0)70 313 00 99
Internet: www.veb.net
E-mail: info@veb.net

Philips not recession-proof after all

Dear Philips shareholder,

Philips consists of three distinctly different divisions that each require a totally different approach. The Healthcare division (medical systems) performed reasonably well in 2008, but Consumer Lifestyle in particular (television sets, audio systems, shavers and domestic appliances) proved to be weak. Clearly the transformation process focusing on 'health and well being' that CEO Gerard Kleisterlee initiated has not been completed yet.

***Vision 2010* targets abandoned**

In December 2008 the electronics concern was forced to announce that the targets formulated in their *Vision 2010* strategy were aimed too high. So this meant a profit warning. Philips is being hit hard by the recession on virtually all fronts. An operating result before amortisation (EBITA) of over 10 percent from 2010 is no longer realistic. To illustrate this: in 2008 an EBITA margin of just 3.5 % was realised - in 2007 this was 7.7 %. For the period 2008 to 2010 Philips will not be able to realise a comparable average annual turnover growth of 6 percent. For the same period their long term targets for the separate divisions will also be abandoned, without clarifying when they should be met.

Two divisions showing signs of weakness

Final quarter figures for 2008 almost read like a disaster scenario. Philips' quarterly turnover dropped from EUR 8.4 to 7.6 billion. EBITA arrived at EUR 141 million, in sharp contrast with the EUR 871 million it reached in the same quarter a year earlier. The net result was well over EUR - 1.5 billion. In 2007 this was EUR 1.4 billion. The Consumer Lifestyle and Lighting divisions in particular have been hit hard by the economic downturn. Philips expects Consumer Lifestyle to shrink considerably in 2009 so that Healthcare may become their largest division. The medical division is now a bright spot, with turnover growth rising by 9 percent to EUR 2.6 billion and with an EBITA of 14.2 percent. But here, too, prospects are gloomy, because, for example, hospitals will have fewer investment opportunities. For the Lighting division, which Philips expanded by acquiring Genlyte and Lumileds at the top of the market for well over EUR 2 billion, the effect of the crisis in the construction industry and the automotive sector will only show in this year's figures. So it looks like the worst is yet to come.

Without any major changes consumer electronics will remain Philips' problem child, which, because of its low valuation, keeps inhibiting expansion opportunities for the other divisions. In order to make the electronics concern less cyclically sensitive, the VEB is of the opinion

that divesting this notorious loss making activity should at least be considered. The VEB would like Philips to clarify how they are going to weather the storm in the short term in these challenging market circumstances and how they propose to develop their growth strategy.

Performing worse than peers

Philips compares itself with a group of eleven international competitors, including Electrolux, Siemens and General Electric. This comparison reveals a gloomy picture. Based on the 2008 total shareholder return (TSR) Philips is lagging behind despite a major shares acquisition programme of well over EUR 3.3. billion. Only General Electric is performing worse, mainly because their financial branch is in some difficulty. In the long term, TSR has not been very impressive, either. When Gerard Kleisterlee took up the position of CEO in 2001 Philips was quoted at circa EUR 35 Euros but this rate has now dropped to EUR 13.

Poor to average performance generously rewarded

Last year the shareholders' meeting voted against the proposed remuneration plan. That is why for 2009 Philips is introducing an adjusted long term remuneration scheme for their shares and options. The VEB concludes that Philips' position hasn't evolved in a positive way, however. Philips keeps generously rewarding a below average performance, when in a situation like this a bonus is not appropriate at all. If, for instance, Philips is ranked seventh (as regards stock market results and dividend) within a group of twelve competitors, then board members will still get 80 % of shares. Meanwhile the maximum share bonus is significantly increased from 120 % to 200 %. On the other hand, if Philips hits rock bottom no shares will be allocated at all. The VEB also strongly objects to the free allocation of shares: if board members still own shares three years after allocation, they will get a bonus share for every five shares.

As to the proposed options scheme the VEB would like to point out that even if Philips performs really poorly (the lower 25 % of the peer group) 80% of the options will still be paid to their board members. This means a bonus is guaranteed without achieving anything. In view of the low achievement threshold for the shares programme and for the options scheme in particular, the VEB advises shareholders to vote against the new long term remuneration plan.

On behalf of the Vereniging van Effectenbezitters (Dutch Investors' Association)

Jan Maarten Slagter, managing director

In case you would like to respond to this letter, please send an email to info@veb.net

Note: When this letter was drawn up the annual figures for 2008, the annual report and the agenda for the shareholders' meeting had not been available as yet