Long-Term Incentive Plan

Introduction

Please find below the main features of the Long-Term Incentive Plan (LTIP), approved by the General Meeting of Shareholder. Future substantial changes to the LTIP applicable to members of the Board of Management will be submitted to the General Meeting of Shareholders.

Features of the Long-Term Incentive Plan

Type of plan

The long-term incentive plan (‘LTI Plan’) allows for the award of performance-related shares (‘performance shares’), without the facility to grant options.

Eligibility

Under the LTI Plan members of the Board of Management will be eligible. A similar plan will apply to senior management and key employees.

Size of awards

The annual award size is set by reference to a multiple of base salary (compared to a fixed number of options and restricted share rights in previous years under the current LTI Plan).

For the CEO the annual award size is set at 120% of base salary. For the other members of the Board of Management the annual award size is set at 100% of base salary\(^1\). This is considered to be a mid-market level against leading European listed companies.

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\(^1\) For members of the Board of Management from the United States of America, the size of the award can be doubled.
The actual number of performance shares to be awarded is determined by reference to the average closing price of the Philips share on the day of publication of the quarterly results and the four subsequent dealing days.

**Vesting schedule**

A cliff-vesting three years after the date of grant applies, dependent upon the achievement of the performance conditions (compared to a three-year tranched vesting for restricted share rights granted in previous years under the current LTI Plan).

During the vesting period, the value of dividends will be added to the performance shares in the form of shares. These dividend equivalent shares will only be delivered to the extent that the award actually vests. Unlike the current LTI Plan, no premium shares will be awarded under the proposed LTI Plan.

**Performance conditions**

Vesting of the performance shares is based on two equally weighted performance conditions:
- 50% Relative Total Shareholder Return (‘TSR’); and
- 50% Adjusted Earnings per Share growth (‘EPS’).

**TSR**

A ranking approach to TSR applies with Philips itself excluded from the peer group to permit interpolation. The TSR peer group is extended from 11 to 21 companies\(^2\). To the current 11 peer companies, 10 companies are added that together reflect the portfolio of Philips and are comparable in terms of industry, market capitalization, revenues and number of employees.

The performance incentive-zone is outlined in the table below:

<table>
<thead>
<tr>
<th>TSR Philips</th>
<th>≥21</th>
<th>≥20</th>
<th>≥19</th>
<th>≥18</th>
<th>≥17</th>
<th>≥16</th>
<th>≥15</th>
<th>≥14</th>
<th>≥13</th>
<th>≥12</th>
<th>≥11</th>
<th>≥10</th>
<th>≥9</th>
<th>≥8</th>
<th>≥7</th>
<th>≥6</th>
<th>≥5</th>
<th>≥4</th>
<th>≥3</th>
<th>≥2</th>
<th>≥1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay-out</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>60%</td>
<td>60%</td>
<td>100%</td>
<td>120%</td>
<td>140%</td>
<td>160%</td>
<td>180%</td>
<td>200%</td>
<td>200%</td>
<td>200%</td>
<td>200%</td>
<td>200%</td>
<td>200%</td>
<td></td>
</tr>
</tbody>
</table>

For performance between 50th percentile and 25th percentile a ranking method with straight-line interpolation would apply.

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\(^2\) ABB, Covidien, Danaher, Eaton, Electrolux, Emerson Electric, General Electric, Hitachi, Honeywell International Inc, Johnson Control, Johnson & Johnson, Le Grand, LG Electronics, Matsushita, Medtronic, Procter & Gamble, Schneider Electric, Siemens, Toshiba Corp, Smiths Group, 3M.
The performance incentive-zone with zero vesting below the 60th percentile and 200% vesting for performance levels above the 25th percentile is considerably steeper than in the current LTI Plan. The Supervisory Board will review over time the possibility to further reduce the vesting for below median performance.

**EPS**

EPS growth is calculated applying the simple point-to-point method at year-end.

Earnings are the income from continued operations attributable to shareholders as reported in the annual report.

To eliminate the impact of any share buyback, stock dividend etcetera, the number of shares to be used for the purpose of the EPS realization will be the number of common shares outstanding (after deduction of treasury shares) on the day prior to the beginning of the performance period.

Earnings are adjusted for changes in accounting policies during the performance period. The Supervisory Board has discretion to include further adjustments in extraordinary circumstances (e.g. impairments, restructuring activities, pension items) with a significant impact.

The following performance incentive-zone applies for EPS:

<table>
<thead>
<tr>
<th>Adjusted EPS growth</th>
<th>Below threshold</th>
<th>Threshold</th>
<th>Target</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay-out</td>
<td>0%</td>
<td>40%</td>
<td>100%</td>
<td>200%</td>
</tr>
</tbody>
</table>

The EPS targets will be set by the Supervisory Board annually. EPS targets are considered to be company sensitive therefore these will be disclosed retrospectively at the end of the performance period. EPS targets and the achieved performance will be published in the first annual report after the relevant performance period. The Supervisory Board will review over time the possibility to move to ex ante disclosure at the start of the performance period.
**Example**

In year 1 a member of the Board of Management receives X performance shares. At the end of the three year performance period Philips’ TSR performance is exactly equal to the TSR performance of the peer company ranking 10, resulting in a vesting of 120% for the TSR part. The EPS performance equals the target performance, resulting in 100% vesting for the EPS part. The total vesting for this award will be: 

\[ 50\% \times 120\% + 50\% \times 100\% = 110\% \]  

of the number of performance shares awarded in year 1

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Award of X performance shares</td>
<td></td>
<td></td>
<td>Delivery of 110% of X shares</td>
</tr>
</tbody>
</table>

* Example is excluding the effect for stock dividend added during the performance period.

**Grant dates**

There are four dates of grant per year, which will be on the last day of the five-day averaging period after publication of the annual results and the quarterly results. The main grant will be once a year after publication of the first-quarter results; other dates of grant can be used in exceptional circumstances, for example in the event of initial grants to new employees. In 2013, as an exception the grant will be made on May 3 after approval of the LTI Plan by the Annual General Meeting of Shareholders.

**Claw-back**

As stated in the Corporate Governance section of the annual report, as of 2009 the so-called claw-back clause of the Dutch Corporate Governance Code is applicable to LTI grants to members of the Board of Management. For grants as of 2013, the claw-back clause will be extended to include cases of a serious violation of the Philips General Business Principles or applicable law.

**Change of control**

In the event of a change of control of the Company, the Supervisory Board at its sole discretion can decide to accelerate the vesting of any unvested awards, subject to the achievement of the performance conditions to the date of completion of the change of control in accordance with the performance incentive-zone in place, taking into account the principles of reasonableness and fairness and, unless the Supervisory Board determines otherwise, the shares which vest will in principle be reduced on a time pro-rated basis.

**Mandatory share ownership**

Simultaneously with the introduction of the proposed LTI Plan, the guideline for members of the Board of Management to hold a certain number of shares in the company is tightened, i.e. 300% of base salary for the CEO and 200% of base salary for the other members of the Board of Management. The guideline is to retain all after-tax shares and not to require own purchases.
Annual pool size

The maximum number of shares to be granted on a yearly basis in aggregate to all employees under LTI Plans will not exceed the current pool size of 17.5 million (excluding dividend equivalent shares or vesting above 100%) of which 3% is available for the members of the Board of Management.

Changes to the plan

Substantial changes to the LTI Plan applicable to the Board of Management will be submitted to the General Meeting of Shareholders for approval, such as changes in the peer group - for reasons such as delisting of a peer company or a substantial change of its activities - exceeding two companies on an annual basis (for instance due to a merger of two peer companies) or four companies in total.

Deviations on elements of this plan in extraordinary circumstances, when deemed necessary in the interests of the Company, will be disclosed in the annual report or, in case of an appointment, in good time prior to the appointment of the individual.