

FINAL TRANSCRIPT

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PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

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OVERVIEW

During 2Q05, in spite of pressure on results, PHG announced that it continued with its brand repositioning, which amounted to EUR69m. The Co.'s balance sheet remained very strong for 2Q05. During 3Q05, the expenditure will be around EUR20m, and 4Q05 brand campaign is expected to be approx. EUR60m. During 2Q05, PHG sold its remaining NAVTEQ shares. Q&A Focus: Financials, mobile, medical, brand spending, semiconductors, and TSMC.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

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Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Royal Philips Electronics second quarter results 2005 conference call, on July 18, 2005. The introduction will be given by Mr. Gerard Kleisterlee, President and Chief Executive Officer of Royal Philips Electronics. And with him will be Mr. Pierre-Jean Sivignon, Chief Financial Officer of Royal Philips Electronics. For the introduction, 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 web cast on the website of Royal Philips Electronics. I will now hand the conference over to Mr. Gerard Kleisterlee. Please go ahead, sir.

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Thank you. Ladies and gentlemen, good morning. And let me first welcome you to this conference call for the second quarter results for Royal Philips Electronics. With me, I have Pierre-Jean Sivignon, who joined us as Chief Financial Officer one month ago. I will make a few introductory remarks and then we'll get into your questions.

From a Philips perspective, we continue to make progress with the implementation of our strategy and deliver on our management agenda for 2005. As such, we were pleased to see the continued strengthening of our Medical Systems operations, with 6% comparable year-on-year growth, as well as a further improvement in operating margin. Also, order intake remained strong, with an 8% growth for equipment orders. The announced acquisition of Stentor further adds to the picture.

During the quarter, we saw a further slowdown in retail markets in Europe, which has mainly affected our Consumer Electronics and Domestic Appliance sales. The impact on the results of Consumer Electronics has been limited, which gives us further confirmation that our business model has withstood the sales decline. In Domestic Appliances and Personal Care, we were pleased to see that our gross margin was not affected and that it is only a volume issue.

Our Semiconductor margin increased sequentially and we recently announced a new organizational structure that we believe will make us a more effective Company. However, there is still much more work to be done here to reach acceptable results, which will take us a number of quarters to complete.

As a consequence of the slowdown in retail sales, we saw at an early point that inventories were rising and at the end of June they would be higher than we need. However, as a consequence of taking early action, the June inventories did not rise above the levels of the end of May, and this subject has our full attention.

Another aspect of inventories is inventories in the channel, and the indications that we have are that, in Consumer Electronics, there are some excess inventories, in particular of B and C brands, but not of Philips products. Also, in Domestic Appliances and Personal Care, there appear to be some surplus inventories, especially in some commodity categories.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

In spite of pressure on results, we have continued with our brand repositioning and, during the quarter, this amounted to 69m. We decided to keep all the expenditure in one place in our results, so that it's easier for you and us to follow. During Q3, the expenditure will be around 20m and for the fourth quarter we expect approximately 60m for our brand campaign. Evaluation of results from the campaign so far show increased awareness as well as preference for the Philips brand as a result.

In spite of the current market weaknesses, our long-term plans remain unchanged. During the quarter, we sold our remaining NAVTEQ shares and we will continue to reduce our holdings in other companies and divest low-growth, low-margin businesses. With the recent announcement of the Stentor acquisition, we have continued our program to reallocate capital to predominantly Medical but also Lighting and Domestic Appliances, with the aim to have a higher portion of our capital in higher margin, more predictable businesses. We also have now completed our share buyback program that we announced back in January.

Our balance sheet remains very strong. However, this mainly reflects a timing difference between the receipts of cash from the sales of businesses and financial holdings and the investments that we are intending to make to strengthen our operational activities.

I will now open up this call for your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. [OPERATOR INSTRUCTIONS]. The first question comes from Janardan Menon. Please go ahead.

Janardan Menon - *Dresdner Kleinwort Wasserstein - Analyst*

Yes, hi. Good morning. Just to get a bit more clarity on what exactly you are trying to guide, by saying that you have inventory in the channel and you have weak markets in Consumer in Europe in some products and in the U.S. in other products, while also saying that your own products should do well because of innovation. Normally, into Q3, you will see a low single-digit quarter-on-quarter upside in areas like DAP and Consumer. Are you suggesting that that might not happen because of the weak markets and the channel inventory? Or is it that you should be able to achieve at least that much?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Difficult to predict. As we go into the third quarter, particularly in DAP, we are coming with quite a number of new products into the market. And that will affect, hopefully in a positive way, the sales, which is one of the reasons, also, why in those categories we certainly are low in inventory in the channel. It remains very much a matter of the general mood in the market, in particular in Europe, that will determine how top line, for the third quarter for these activities, will look.

Janardan Menon - *Dresdner Kleinwort Wasserstein - Analyst*

Okay. And just a follow up, which I think you may say you can't answer, but on MedQuist, is there any kind of clarity emerging at all, in terms of what kind of margin hit on the overall Medical division that could take in the next couple of quarters, as well as when it could be resolved, altogether?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, that is emerging, but at this moment I cannot be very specific about it. Though I can say that I am hopeful that, within the next quarter, we might be able to become a little bit more specific and get back to you with the impact.

Janardan Menon - *Dresdner Kleinwort Wasserstein - Analyst*

Okay. Thank you very much.

Operator

Thank you. The next question comes from Mr. Bram Cornelisse. Please go ahead, sir.

Bram Cornelisse - *Merrill Lynch - Analyst*

Hi, good morning. Can I just ask for an update on Mobile Display Systems? And also, maybe, if you could tell us what the losses were for that activity in the quarter, because it seems that, if I'm not wrong, the revenues were actually up sequentially?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, the revenues were down 36 or 38%, year on year, so we see significant weakness there on the top line. That obviously also impacts the bottom line, and the activity made a loss in the third quarter, but we don't break out those results specifically.

Bram Cornelisse - *Merrill Lynch - Analyst*

I guess my question is I think in Q1 the revenues were down 45% year over year. And because it seemed that you were specifically negative a month ago on what was going on in MDS, I'm just wondering whether that actually materialized, because the profits were -- or the losses were not that bad, overall, in Other Activities.

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, I understand your question and that has more to do with the fact that, in some other sectors in Other Activities, we had some smaller positive incidental results that made overall Other Activities look better, maybe, than you might have expected. I think that, in MDS, we see a negative trend, be it less pronounced than in the first quarter, and that continued also in the second quarter. And we are looking actively how to further proceed with this activity.

Bram Cornelisse - *Merrill Lynch - Analyst*

Okay. Do you know when you're going to be able to say something on that?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

I hope on relatively short term.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Bram Cornelisse - *Merrill Lynch - Analyst*

Okay. One other, different question, please. Could you tell us what percent of the brand spending is in Europe?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

I cannot give you exactly the percentage, but if you look at -- in the second wave of the campaign, the focus countries were, outside of Europe, the U.S.A., China, India and, in Europe, Italy, Spain, France, Germany, U.K. and the Netherlands. And you may assume that brand spending was more or less proportional to the positions that we have in those countries.

Bram Cornelisse - *Merrill Lynch - Analyst*

Okay. Thank you very much.

Operator

The next question comes from Mr. Uche Orji. Please go ahead, sir.

Uche Orji - *JP Morgan - Analyst*

Good morning. Can I just ask a question on the DAP? You talked about inventory, the channel, or certain products. And at the same time, you're talking about gross margin holding up. If I look at that, what should I be expecting for operating margins for DAP into the third quarter? Will volumes continue to decline and therefore we expect margins to go down again?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

The target that we have for that division is to produce, over the year, mid double-digit EBIT numbers. And we are going into, of course, the selling season. The peak of their selling season is around September, October, partly into November. We are coming with a whole new range of products that should further support both the position in the market and the margins. When we hinted at inventory, then that is particularly in what I call the commodity categories. I don't consider our shaver, for example, a commodity category, but I do consider the water kettle a commodity category. And you see a trend, in particular in the European market, towards B and C brands at very low prices for some of these categories.

Uche Orji - *JP Morgan - Analyst*

Okay. Just one more question on Semiconductors. Just to put it in perspective with what we're hearing everywhere else, you seemed a bit more cautious than maybe some of the other companies that play in Semiconductor. What are you -- are you still seeing indications of inventory in certain areas? What product areas are doing better, or in other words, can you give us some color to understand -- because if we compare you against your U.S. peers, they seem to be more positive than you are sounding in Semis. Any clues you can give us will help.

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, I could try and give that a little bit more color. First of all, when you look at market development, then you have to take in mind that our portfolio is more geared towards consumer applications than the portfolio of some of our U.S. peers. And in particular, I think the difference will be through the exposure to the computer and the PC end market, which is a segment that

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

seems to do better, where growth has been revised upwards. And people that are more into that segment of the market are more optimistic about the short-term outlook than maybe we are at this point in time.

Our portfolio is more towards the consumer end, where we see, in particular, weakness in traditional consumer electronic markets for TV, DVD and the like. And in the mobile phone market, where we have a quite reasonable position, we see of course some shift in positions of the top contenders. And then you just have to look at who's supplying whom to see what the potential impact on everybody's top and therefore bottom line is.

Uche Orji - *JP Morgan - Analyst*

Just picking on the mobile phone point, are you one of the winners in the sense of this shift among the contenders?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

We have a strong position with a number of the top five players, and so we expect that we have an opportunity to continue to do well there.

Uche Orji - *JP Morgan - Analyst*

Right. Thank you very much.

Operator

The next question comes from Mr. Nicholas Gaudois. Please go ahead, sir.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Yes, hi there. Could I have some clarification, first of all, on Lighting? You seem to be again cautious in the near term, but confident on margin development forward. Would you expect IFO margins from Lighting to be broadly similar to 2004 for the whole of 2005?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Can't really tell that precisely. To tell you what's happening in Lighting is that we have increased our R&D spending, with about 1.5 to 2%, in order to establish two new growth businesses that will add further to top line growth. That is, on one hand, an investment in solid-state lighting applications. And the other one is an investment in the start up of an LCD backlighting activity, and that will come on-stream towards the end of the year.

There we, at the moment, bear the burden of the R&D investment, whereas the turnover, and therefore the contribution to profit, only is developing from the later part of this year. That short term impacts, to some extent, the margin in Lighting. For the rest, I think that the gross margin in Lighting, as the gross margin in DAP, held up quite well and is expected to hold up also as we go forward.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Okay, thank you. And on Semiconductors, could you tell us where utilization rate is expected to go in your third quarter and where are your lead times vis-a-vis three months ago?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

I don't see, at the moment, from the order book which is slightly -- the book to bill is slightly above one, so I don't see a big short-term variation there. In the utilization rate, utilization rate in the second quarter was at 77%, up from 75% in the first quarter. And I expect it, also, in the third quarter, to be in that area. Maybe a touch higher.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Okay. And the lead times? Are they still relatively short, or have they started to expand again as we move through the cycle?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

No, lead times are short. Visibility of order book, also, is very short. And apparently, customers are still expecting to be supplied almost from stock or from free capacity. Stocks in Semiconductors are well contained. We don't have any inventory issues there. So any upturn in end demand immediately will lead to better utilization of our factories.

Nicholas Gaudois - *Deutsche Bank - Analyst*

So if that's the case, that's something you could potentially see at the back end of the quarter, if the demand is there, of course?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

If demand is there, then you will see that.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Okay, thank you very much.

Operator

The next question comes from Mr. Adrian Hopkinson. Please state your question, sir.

Adrian Hopkinson - *WestLB - Analyst*

Good morning. Just to follow on, on the inventories side of things, could you give us some idea of how you expect the inventories to develop as far as the rest of the year is concerned? Do you see it as feasible to bring them back to the levels they were at the beginning of the year?

And I have a similar question for receivables. I wonder whether you could give us some idea of what has been driving the receivables up in the last two quarters.

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Well, as far as inventories are concerned, the task that the organization has is certainly to continue a track record that we have set over many years, that every year we manage to get inventories a notch further down. This quarter, we have, for the first

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

time, not been better than the same quarter of the year before. The organization has taken that to heart. And so the objective is, clearly, to be at or below the levels that we had in previous years.

As -- with respect to receivables, the increase in receivables is mainly due to the dividend that we received on TSMC. That has about a 200m impact. So I think there's nothing wrong with receivables in itself, but it is the booking of the dividend payment.

Adrian Hopkinson - WestLB - Analyst

Thank you very much. Thank you.

Operator

Next question comes from Mr. Luc Mouzon. Please go ahead, sir.

Luc Mouzon - Exane BNP Paribas - Analyst

Yes, hi. Good morning. I'm just coming back -- a follow-up question on the previous question about working capital. I'm still a bit confused. What this means that we could still, at least, anticipate the normal seasonal pattern for Philips, I think, with a reverse of trend as of the third quarter and some positive cash net contribution from the cash flow from operations in the working capital for the third quarter. Is that the normal understanding of your --?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Yes, absolutely. In terms of seasonality, we expect a normal pattern of events. That is that, in particular on the consumer side of the business, inventories build towards the middle of the year and then you see a sharp decline of inventory, starting from September and then continuing with a strong decline into December. That is absolutely what you must expect.

Luc Mouzon - Exane BNP Paribas - Analyst

Okay. My second question is just regarding Europe as a whole, with sales down about 6% in the second quarter. Any change there, compared to your views at mid June? And which countries have been, let's say, have been the most affected there?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

No, I don't think that's the picture compared to the update that we gave mid June has changed. Consumer demand is weak. You see that on every league board that you get about retail sales, also in our sector. The weak countries, in particular, I think U.K. retail is down very much, Italy is very affected, the Netherlands is the laggard in Europe. France and Germany also are weak. It's -- I think in terms of retail environment at the moment, Spain is one of the better countries in Europe.

Luc Mouzon - Exane BNP Paribas - Analyst

Okay. That doesn't mean that you see that number on the second quarter as a trap or as a limit done? We could still have this trend to continue over the third quarter, according to your views?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

I think that, apart from specifics with respect to new product introduction, that greater trend overall in the consumer environment you will have to count with a similar environment in the third quarter as we have seen in the second quarter.

Luc Mouzon - *Exane BNP Paribas - Analyst*

Okay. Thank you very much.

Operator

The next question comes from Mr. Didier Scemama. Please state your question, sir.

Didier Scemama - *ABN AMRO - Analyst*

Good morning, gentlemen. Just a quick question on Semiconductors. If you could just come back, in market, if you could characterize what you see in terms of demand. You see normal seasonality, it seems, in the third and fourth quarter at the moment. Can you maybe just differentiate the view on wireless, consumer and maybe your multi-market position, please?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

We see multi market doing relatively well. We see, also, good demand in our communications segment. We see the weakness, really, in our home consumer environment.

Didier Scemama - *ABN AMRO - Analyst*

Okay. And just a follow-up question on the portfolio. You've announced the divestment of some of your stake in LPL. Also, TSMC, you've basically exited Atos. I'm just wondering, after that, are we looking at divestments more of part of the consolidated business, or do you still intend to reduce further your stakes in either TSMC or LPL?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Well, as you have been able to see from the announcements that we have made and the listings that -- the filings that we have done, when we have gone to market, both with TSMC and LPL, we will end up in a new lock-up period. That does not prevent us from selling down shares in the market directly. But we're also looking at other opportunities, together with our partners, to further deal with that, as we have an intent to reduce our stakes and use the proceeds to strengthen our wholly owned operations.

Didier Scemama - *ABN AMRO - Analyst*

Okay. So that would be more potentially in parts of the consolidated business that you would look at further shrinking the business?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Sorry, can you repeat that question?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Didier Scemama - ABN AMRO - Analyst

I mean, when you are looking at divestments, you are looking more on miscellaneous or Other Activities.

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Yes, we have -- in Other Activities, we have the portfolio of corporate investments, where we have been clear that that is a portfolio that is up for sale. And we would be looking, in general, to continue on a path that we have started a few years ago, in divesting what you call low-growth, low-return businesses.

Didier Scemama - ABN AMRO - Analyst

Right. And just a final question on these financial proceeds. You made it clear, in the past, that you were looking number one at acquisition, number two at dividends and number three at share buybacks.

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Correct.

Didier Scemama - ABN AMRO - Analyst

Share buyback is finished for 750, is that still bottom of the agenda, or do you have any plans for further share buyback?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

At the moment, we don't have a plan for share buyback, but certainly these are the three items that we have on the agenda, as far as the use of cash is concerned. And at regular intervals, we will -- we are doing our cash planning, we look at the acquisition pipeline and the flexibility we need for that, we look at the money we need to reserve for dividends. And if there is, beyond that, cash available, then certainly share buyback will be one of the considerations.

Didier Scemama - ABN AMRO - Analyst

Brilliant. Thank you.

Operator

The next question comes from Mr. Thomas Brenier. Please go ahead, sir.

Thomas Brenier - Societe Generale - Analyst

Good morning. I'd like to comment on the Medical Systems unit. I'd like to have an idea of the mix between systems and services, both for revenues and especially for orders, if that's possible. And I'd just like to hear you confirming that you now expect more than 5% growth for the division for the full year. Thanks.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, I think that's -- with respect to your last comment, that is indeed the case. We grew 6% comparable organically in the second quarter. We have booked strong order entries in the previous quarters. We focus, in this quarter, in our reporting, specifically on the order intake with respect to products, hardware, where we have an 8% comparable order growth. In previous numbers we gave you, that was a mix of hardware orders and service orders.

And we decided to focus on hardware orders, because that is more directly related to the future development of turnover, as service orders, service contracts, are sometimes booked for a longer period of time and the bookings, the order bookings, do not materialize immediately in annualized turnover. So when you have seen much higher numbers in the past, then that was because we are strengthening our service activity. And we see a further shift in the division of our revenue between hardware and services, in the direction of services.

Thomas Brenier - *Societe Generale - Analyst*

Thank you very much.

Operator

The next question comes from Mr. Francois Meunier. Please go ahead, sir.

Francois Meunier - *Cazenove - Analyst*

I just have a question about the long-term strategy in Medical. You seem to be acquisitive in the future -- the acquisition you've made of Stentor seems to be quite expensive at five times sales. Is this the kind of acquisitions that you're looking to do in the future, rather than larger ones with lower margins that you would bring up to mid teens?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

We're looking at a range of opportunities there, and for us the starting point is always the fit with the strategy and the opportunity for value creation. And that can come from different angles. We're looking at a range of smaller but also larger acquisitions.

In the case of Stentor, of course, the level of profitability and growth that that company enjoys more than justifies the price we purchased. For other targets, that situation can look different. It is not always the type of start-up businesses as Stentor was that we envisage to acquire. We are also looking at a number of somewhat more mature businesses, but still with growth and profitability, that will add to the growth and profitability of Philips and Philips Medical Systems.

Francois Meunier - *Cazenove - Analyst*

Okay. Now, regarding your hedging policy. The dollar has strengthened quite a lot in the past three months. Would you feel more optimistic, given that you're selling more in dollars than you have cost?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

We are not too much long in dollars. The basic effect that it will have, the current strengthening of the dollar will have, is that we see less of a translation difference between dollar revenue and profit into euro revenue and profit. So the difference between nominal and comparable numbers will reduce. As you have seen, it has reduced also in the second quarter. That will be the main effect. It will not have a massive effect otherwise.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Medical Systems is fairly balanced. Domestic Appliances is fairly balanced. CE sources a lot in the dollar area, but then so does everybody, so that will have everywhere the same impact, I think, on market prices. The division where, I guess, a stronger dollar has the most positive effect is in Semiconductors, because that, globally, is a dollar-dominated business, both in terms of sales price and in terms of a large amount of the cost. And with somewhat more of a European cost base with two large [indiscernible] in the case of Philips, there, a stronger dollar certainly helps.

Francois Meunier - *Cazenove - Analyst*

Okay. Just one question, if I may, on your tax rate for 2005. You had a positive tax effect this quarter. What will be the tax rate for the year, now?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

We think that the tax rate, ultimately, will be in the order of magnitude of 25%, the effective tax rate.

Operator

The next question comes from Mr. Robert Carroll. Please go ahead, sir.

Robert Carroll - *RBC Capital Markets / Dain Rauscher - Analyst*

Good morning. The other question, was that 25% you said?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

That's correct.

Robert Carroll - *RBC Capital Markets / Dain Rauscher - Analyst*

Okay. And then, just briefly, within -- the target IFO margins are 5 to 15% and then, in reference to your opening comments, would this be several quarters before Philips reaches the low end of this target range?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

No. If we have the normal seasonality that you also see particularly in our part of the Semiconductor business, then of course you will have to see a somewhat stronger second half than first half. So the lower end, we should, with a somewhat favorable cycle, we should reach earlier. What Semiconductor's telling me is that 5% in the next downturn cycle is the difficult target to beat.

Robert Carroll - *RBC Capital Markets / Dain Rauscher - Analyst*

Okay. And then, could you just share with us what else would need to be done internally to be able to reach that 5% target or that range?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Well, it is further streamlining the manufacturing effectiveness. It's a combination of a number of factors, mostly hard work. Some pruning of the portfolio and the manufacturing streamlining, a further increase of the yields in some of the production lines. It's detailed hard work, and therefore my comment that it will not come easy in the next few quarters. It's really deep down in the organization that the deployment of these targets has to be realized.

Robert Carroll - *RBC Capital Markets / Dain Rauscher - Analyst*

Great. Thank you.

Operator

The next question comes from Mr. Jan-Willem Berghuis. Please go ahead sir.

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

Yes, just a small question on the unallocated line. Since the marketing spending has been guided downwards in Q3, what is the run rate of losses excluding marketing? I think in Q3 it was around 120m. Is that -- or in Q2, is that the same in Q3?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

That's a difficult one. We have guided not necessarily the marketing expense downwards, because you know the marketing expense comes in bursts. We had a campaign in the second quarter and we will do a campaign for the selling season, which is September, October, November. And therefore, it only hits the third quarter in a limited way.

When you look at Other Activities and unallocated, then in unallocated, excluding brand campaign, you will not see a change in the run rate, I think, that you have seen. You simply can project forward because these are basically fixed costs, and the only variant is the brand campaign in Other Activities. Your question was about the unallocated line?

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

Yes it was, actually. And maybe as a follow up on the marketing side, you mentioned the brand awareness improved due to the marketing campaign. Can you give us some numbers on brand awareness?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, I could, but not top of my head now in the context of this call. You have to see that that differs, of course, widely per country where we go to market. One of the most remarkable facts of the brand campaign is that we found out that our brand awareness in China is almost as high as it is in The Netherlands, and that the brand awareness in the U.S., while improving with a few percentage points, still is at a level where we see some of the lowest awareness's of any of our key countries. And therefore, still a focus of attention to further improve that. But you're seeing also in the U.S. good progress on that front.

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

Okay. Thanks very much.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Operator

The next question comes from Antoine Badel. Please state your question sir.

Antoine Badel - CSFB - Analyst

Yes. Good morning. On the Semiconductor division guidance for Q3, you're guiding to mid single digits sequential revenue growth, yet book to bill last quarter is only one. Am I correct in assuming this is a reflection of increasing turns orders, and what was the level of turns orders in Q2, please?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Yes. I couldn't give you the exact level of turns orders, but we've seen in the last two quarters a shift indeed in the direction of turns orders, because people are cautious, the equipment manufacturers are cautious and, therefore, order at the very, very last moment. And that is something that, as a pattern, we still see in Q3 as well.

Antoine Badel - CSFB - Analyst

And on the action plan in Semiconductors, in order to get to this 5 to 15% IFO margin through the cycle, could you give us a little bit more detail in terms of the parts of the portfolio you're considering pruning? If you're doing anything to manufacturing capacity and what is the action plan to improve execution?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

In manufacturing capacity, it is the rigorous implementation of a few restructuring plans that we have announced earlier. And as you may know from the press, we're, for example, still struggling to come to conclusion also with the Unions around our Hamburg factory, where we reached conclusion in Germany around the Berlin factory to change the work hours pattern, and thereby significantly boost the efficiency of the operation. We are still not finalized those discussions in Hamburg, so that is one of the things that we need to do. And that, further, it's taking every measure in those factories to bring them to competitiveness through rigorous benchmarking of processes of cost, with their Asian competitors, including our own factory in Singapore, by the way.

On the portfolio side, there are no big steps to be taken there, but you will appreciate that if you have something like 30 business lines, you have a rather wide product portfolio. And so we do some pruning on that front that may not always be very visible but leads to less overheads, to less scatter of R&D expense, and more focus on the number of critical battles that we need to win. In particular, we try to bring more resources into our mobile phone area, where we have a good position and we see the need and the opportunity to further strengthen that also by creating more effectiveness in R&D.

Those are the most important steps that we need to take, and then it is the simplification of the whole supply chain management process, which is the reason why we have created these four, you could say, end-to-end market-oriented units around automotive and mobile communication and consumer electronics home applications, next to our multi-market Semiconductor units.

Antoine Badel - CSFB - Analyst

And finally, very quickly, could you please say a word on pricing trends in medical, please?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Nothing special. Normal price erosion that you see for existing products in the market, and some compensation of that through innovation, because every time when a new product is introduced there is more functionality and it helps to lift the margin again.

Antoine Badel - *CSFB - Analyst*

Thank you.

Operator

The next question comes from Mr. Stephane Fraenkel. Please go ahead sir.

Stephane Fraenkel - *Oddo Securities - Analyst*

Yes. Hello. Could you talk a little bit about the mobile display unit, the reasons why the Group [indiscernible] there? Is it because of technology or because of price per share?

And also, on a more general basis, could you elaborate a little bit on the divestitures you could happen to do in the future? Do most of the activities in the Other Activities line correspond to your description of low-margin and low-growth businesses?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Indeed, the majority of activities in the Other Activities line corresponds to that description. We have been very explicit about the corporate investment portfolio. We've named the specific businesses in that portfolio and categorized them all, basically, as up for divestment. We have positioned MDS and Optical Storage as standalone units in Other Activities, in order to decide how to move forward. And at the moment, they would certainly classify in the category low growth, low return.

Stephane Fraenkel - *Oddo Securities - Analyst*

And specifically about MDS, why do you see such a poor performance on this activity there?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

It is in a sector that is facing significant competitive pressure. You see it as a consolidating industry, a few months ago [indiscernible] consolidated its activity with the Sanyo activity, and they didn't do that because both were very profitable. There is pressure also because of excess capacity in the LCD area, in particular, from all the generation fabs that saw initially an opportunity to move into this field, with the LCDs.

So the whole industry's structure, at the moment, is one where it is very, very difficult to make good returns, and that is something that we are exposed to as well.

Stephane Fraenkel - *Oddo Securities - Analyst*

Okay. And lastly, on the LCD display, you alluded to the fact you could have to recognize some further provisions there. Could you give us a little bit some color of the extent of the provision you might have to recognize there?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

For LCD, you mean?

Stephane Fraenkel - *Oddo Securities - Analyst*

LCD display.

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

That unit is, of course, facing equally difficult market circumstances for two reasons. One, there is a weak consumer and market demand. Two, LCD prices have been at their bottom, and so the replacement rate of CRT to LCD also is at a fairly high level.

As we go forward, short term, maybe there is some light at the horizon, because we see that LCD prices are strengthening. LCD prices strengthened, that's good for CRT pricing and demand as well, but we have to say that the unit is struggling to make its business plan and produce the cash flows that are necessary. And as we go forward, we will reevaluate that, but at this moment, it is too early to say whether and to what extent that would lead to a further impairment charge.

Stephane Fraenkel - *Oddo Securities - Analyst*

Okay. Thank you very much.

Operator

The next question comes from Mr. Johannes Ries. Please go ahead sir.

Johannes Ries - *Analyst*

Yes. Hello. Some small questions. First, on consumer, you talk about a weak market, also in consumer electronics. Do you see any hopes that maybe at the end of the year that things could get better due to two things? First, the impact of LCD TVs get really a mainstream product in the Christmas business, and secondly, due to the World Championship of football, some of your competitors and other consumer-related companies have high expectations on?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, the World Championship may cast a positive shadow. In general, I do not account with more than normal seasonality, given the general consumer environment that we have. We see a better consumer environment in Asia. For example, consumer electronics boasted strong growth in China. Consumer electronics also did remarkably well in the United States, even though there the consumer environment is not entirely good either.

But I would not take any specific hopes for an upsurge from any of these events that you mentioned. If it happens, we'll take the benefits, but I wouldn't want to speculate on it.

Johannes Ries - *Analyst*

Okay. But you're very convinced to make the 4 to 4.5% margin?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Our division is absolutely convinced that they will be at that performance level. When you talk about that margin, you have to bear in mind that you should not take that as the result at the end of the year for the full year, but that in the course of the second half, we will be at a performance level that when annualized will lead to those results. Because 2005 is the year where we complete, more or less, in consumer electronics, a number of our restructuring plans. So, excluding restructuring, we will be at that performance level, but including restructuring that will be somewhat lower still.

Johannes Ries - *Analyst*

Okay. Maybe a short question for optical storage. After maybe a very good development at the beginning of the joint venture, it looks like things are turning negative. Any reasons for this and could things get better again, or is that market also so difficult in the longer term that even you could try to move away from your joint venture stake, possibly?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Well, I should -- the joint venture in itself is working. What we see there is also, through the joint venture, quite some pressure from the market on a product that rapidly has commoditized, and where initially, in the earlier phase of the drive going to higher speeds, innovations still could help to maintain a certain margin. But where we are gradually coming to the end of the life cycle of this generation of technology, that puts margins under pressure.

Johannes Ries - *Analyst*

Maybe finally, through your acquisition pipeline you talk, you have a couple of things, especially medical in the pipeline, otherwise you execute at the moment a lot at the [indiscernible] side fight for sales in TSMCs, [High West], cheap Philips; Atos (ph) already [indiscernible] stake has gone. Therefore, is it very likely that maybe we could see some action at the acquisition side in the remainder of the year?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

I would be very happy if I could come back to you rather quickly with some acquisitions. But, of course, the timing of acquisitions is difficult to determine, because its approach is between two parties, where we don't control the timing alone on our side. But clearly, we have an acquisition pipeline, we are working on quite a number of opportunities, and as and when we succeed, we will be back to communicate with you as soon as we can.

Johannes Ries - *Analyst*

Good. Thanks a lot.

Operator

The next question comes from Aram Rubinson. Please go ahead sir.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Aram Rubinson - *Banc of America Securities - Analyst*

Hi there. Sorry to go back to this, but could you just clarify the margin guidance in DAP? Because previously, mid teens has been above 15% and is that something you expect to reach in 2005 already or is [inaudible]?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

No, we've said also at earlier occasions that around 15% would be fine. We felt that when DAP went into the direction of margins of 19%, they were overdoing the harvesting of the business. And though DAP might be, in a number of areas, a cash cow, also the cow needs to be fed sometimes. So we've said to DAP, grow your top line, target at an around 15% IFO margin, but focus on growing your top line because we want to grow in the healthier parts of our business and thereby, DAP supports the Philips overall strategy.

Aram Rubinson - *Banc of America Securities - Analyst*

Okay. But just, given the fairly weak Q2 and weakish Q3 guidance, do you expect to be significantly short of this target for the full year or do you expect to be around it?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

No, I think that what we see in DAP is comparable, I think, to what we saw last year, where also Q1/Q2 were relatively soft quarters, also in terms of IFO margins. And that was made up in Q3/Q4, and we hope to repeat that.

Aram Rubinson - *Banc of America Securities - Analyst*

Okay. Thank you. Just really briefly on Lighting again, this 1.5/2% of extra R&D spending, is this something you expect to show up in the margin in Q3 and Q4 as well? Will the extra revenues offset that finance?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, I think it certainly will show up to some extent in the margin in Q3, and maybe to a somewhat lesser extent in Q4 as well, because the revenue of the new business only will start to set in in the fourth quarter.

Aram Rubinson - *Banc of America Securities - Analyst*

Okay. Thank you.

Operator

The next question comes from Victor Baren. Please go ahead sir.

Victor Baren - *SNS Securities - Analyst*

Good morning. On medical, the 8% growth in equipment orders. I thought it was 17% in Q1, what explains the lower growth in Q2?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

I'll explain once again. I tried to explain that before. That's not a drop in order. But the 17% that we gave in Q1 and the 19% that we had in the fourth quarter were order bookings for equipment and service orders. And because we had the same discussion internally, as you can imagine, I said to medical, "you book 18% order growth, why I don't see a much stronger top line?"

And the explanation is that if you segment that order intake into service orders and equipment, that usually the equipment delivery time is within a year. And therefore, equipment order intake is a good guidance for what you can expect revenue development to do. But that on service orders, sometimes you book multi-year service contracts and therefore, not all the order intake leads to revenue within a year. Therefore, we have focused this time on equipment orders only.

Victor Bareno - SNS Securities - Analyst

So it was also 9% in the first quarter?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Well, I don't exactly have the split up now for the first quarter. Let me see. First quarter was 9% for products, again. And the 17% is overall.

Victor Bareno - SNS Securities - Analyst

Okay. Thank you.

Operator

The next question comes from Mr. Matthew [Gable]. Please go ahead sir.

Matthew Gable - Calypso Capital - Analyst

My question's been answered. Thank you.

Operator

The next question comes from [Rene Schmidley]. Please go ahead sir.

Rene Schmidley - - Analyst

Yes. Hello. I would be interested on the TV market, or let's say the development of maybe the regular CRT business, compared to the flat panel TV market. What are your assumptions on growth, maybe for the current year? And maybe, also, a word on the inventory situation. Why did [indiscernible] these two areas?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

I'm afraid I can't provide you with too much detail there, from the top of my head. Neither, I think, from the information that I have in front of me. I can say that in the more advanced markets, value wise, at the moment LCD TV already represents around 70% of the revenue that we do, while it is something around 30/35% of the volume. So you see that CRT TV really is pushed

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

into the lower value categories, and that explains the pressure there is on that part of the market and therefore also, as we discussed in an earlier question, on the CRT joint venture that we have.

Rene Schmidley - *Analyst*

Right. Okay.

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

But I could not give you specific detail on that.

Rene Schmidley - *Analyst*

Okay. That's fine. Thanks.

Operator

You now have a follow-up question from Nicholas Gaudois. Please go ahead sir.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Yes. Hi there. Just a follow-up question on consumer electronics. You basically still plan to move on with TPV on target by Q3. Would you expect this to be accretive to margins thereafter?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes, it is accretive to margins.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Thank you.

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

It does two things. It's accretive to margins and it will allow us to operate in a business model where we will have negative working capital throughout the year.

Nicholas Gaudois - *Deutsche Bank - Analyst*

Okay. Very good. Thank you.

Operator

We also have a follow-up question from Mr. Didier Scemama. Please state your question sir.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Didier Scemama - ABN AMRO - Analyst

Yes. Actually, I wanted to ask the question Nicholas just asked. I just would like a precision or a confirmation of your tax rate. You said 25%?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

That's correct.

Didier Scemama - ABN AMRO - Analyst

I think, if I take the first two quarters, you're between 29 and 30%. Does that mean the second half's going to be much lower?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Well, of course it's impacted by the tax credit that we booked.

Didier Scemama - ABN AMRO - Analyst

It includes it?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

In this quarter, so you have to take that into account, when we talk about -- and you have to see it as an order of magnitude.

Didier Scemama - ABN AMRO - Analyst

Okay. That's brilliant. Thank you.

Operator

We also have a follow-up question from Mr. Adrian Hopkinson. Please go ahead sir.

Adrian Hopkinson - WestLB - Analyst

Could I follow up on the regional sales pattern? You mentioned good sales in Latin America, and that Asia Pacific is affected by MDS and Semiconductors. Could you identify some other regions for us, in emerging markets, where you're seeing some positive trends in this 6b of sales in that area?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Well obviously, when we look at Europe, we have to distinguish between Western Europe, which is slow and sees declines in some areas, and Eastern Europe, where we still continue to post good growth. And that is the first distinction that I would like to make.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Then, across Latin America, but particularly driven by Brazil and Mexico, we see good growth. And when we look at Asia, when I take out the effect of MDS, which is largely affecting our China activities, but the market-oriented activities of consumer electronics, DAP, medical systems, lighting, all boast strong growth in China. And we see good growth also across a number of the Asian countries.

Adrian Hopkinson - *WestLB - Analyst*

When we talk about Eastern Europe, if we include Russia there, do you see the trend there still increasing or is there some impact similar to Western Europe at present?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

I couldn't give you that detail. I have no detailed information here, right now, for the Central European countries individually.

Adrian Hopkinson - *WestLB - Analyst*

Okay. Thank you.

Operator

The next question comes from Maurits Heldring. Please go ahead sir.

Maurits Heldring - *Kepler Equities - Analyst*

Good morning. A question on the advertising and promotion spend in CE and DAP. You're obviously spending a lot now on the global brand campaign. I was wondering whether you could indicate how spending develops in CE and domestic appliances, compared with last year?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

To make the point clear, the reason why we decided ultimately to keep the whole spend for the advertising campaign, what we call the corporate advertising campaign, centrally in unallocated is not to have a confusion on the individual spending levels of the divisions. So the advertising and promotion spending in DAP and in CE is at a comparable level, as it was last year. And we didn't want to pollute that with the effect of the brand campaign, because then, for you but also for us, the year-on-year comparison of the performance becomes difficult. So we try to keep that apart.

So for the ongoing business, in all divisions, but particularly in DAP and CE, the advertising and promotion spending is on a comparable level as last year, and will be also for the coming quarters.

Maurits Heldring - *Kepler Equities - Analyst*

Okay. Excellent. Thanks.

Operator

The next question comes from Mr. Vincent Dekker. Please state your question sir.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Vincent Dekker - *Trouw - Journalist*

Good morning. I have a question concerning India, if I may. I think in the -- Philips is doing pretty good in India, but can you maybe give some more detail about whether it's profitable or not, and how much turnover you have in India?

And the second question is that you have opened up stores in India called Philips Arena, and I was wondering whether that business model could be applied here in Western Europe or other parts of the world too?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

First of all, in India we enjoy good growth across basically all our activities. We see good progress in consumer electronics and that is supported also by this shop initiative. It's a business model that we experiment with in India. Also, given the particular circumstances of the Indian retail market, it is not something that we would quickly export to other areas, although we're always looking at the best possible ways to go to market. But for the moment, we are following that experiment with quite some interest.

We've put a growth focus on India as well. We don't like to have all our growth eggs in one china basket. So for Asia we have three specific growth plans - one for the Asian region, one for China and one for India. And India, at the moment, is well on track to meet the ambitions that we have put in that plan.

Vincent Dekker - *Trouw - Journalist*

Okay. Thank you very much.

Operator

The next question comes from Joost Akkermans. Please go ahead sir.

Joost Akkermans - *Bloomberg News - Journalist*

Good morning. Joost Akkermans, Bloomberg News. Two small questions, the first is on Proctor and Gamble. On Friday, they won approval from the E.U. to buy Gillette, on the condition that they'll sell a unit, Crest SpinBrush. I was wondering if you'd be interested in buying that?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

The answer's no. We have a spin brush unit. You may know that next to the Sonicare we still also have the Sensiflex, so there would not be a need for that. You know also that on some -- on the newest model, the Intelliclean, Crest is our toothpaste partner, so maybe there's still room for interesting discussion.

Joost Akkermans - *Bloomberg News - Journalist*

Right. Because that would be my next question. Are there discussions, how that should proceed or --?

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

Yes. Obviously our healthcare unit is in close contact with P&G to draw the consequences from the new situation that arises after the acquisition of Gillette by P&G.

Joost Akkermans - *Bloomberg News - Journalist*

Okay. Finally, on Other Activities, could you tell me how many companies are in Other Activities and how many of those are -- I assume most are unprofitable but how many are making money, how many are losing money, any feeling there?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

No, they're not all unprofitable. We have a few weaker areas and -- how many activities do we still have in Other Activities? A dozen? About 10 to 12 activities, of which some have had difficulty, given also low -- particularly the ones that are exposed to the tech markets, like [IOBF], and we have an activity in pick and place machines, called Assemble on, and the activity level there still is fairly low. And there are a few other ones that are certainly a little bit -- but overall, that is a portfolio of activities that is up for divestment. Where we divested a few weeks ago a small unit, Philips Aerospace, and we are working on solutions for the other units as well, though that may be a slow process.

Joost Akkermans - *Bloomberg News - Journalist*

That would include MDS then? So once that's --

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

MDS is not part of corporate investments, but also MDS is a unit where we have evaluated a number of options for the business and we are coming to a conclusion on what the future of that activity is in the near future.

Joost Akkermans - *Bloomberg News - Journalist*

Okay. So my final, so the 12 you said, that's all corporate investments then, sorry?

Gerard Kleisterlee - *Royal Philips Electronics - President & CEO*

To be precise, we have 11 units in corporate investments, and then the business activities in Other Activities are made up of the corporate investments portfolio, MDS and Optical Storage.

Joost Akkermans - *Bloomberg News - Journalist*

Okay. Thanks very much.

Operator

The final question comes from [Martin Vondestader]. Please go ahead sir.

Jul. 18. 2005 / 4:00AM, PHG - Q2 2005 Royal Philips Electronics Earnings Conference Call

Martin Vondestader - - Analyst

Thank you. Herr Kleisterlee, could you please quantify your earlier remark on the smaller and bigger acquisitions in the medical sector, please?

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

I could give you a range. Smaller is apparently something in the order of a few hundred, and bigger is something of the order of magnitude of a billion plus.

Martin Vondestader - - Analyst

Okay. Thank you. I'm asking because Philips, earlier on, stated that Philips was only looking for smaller acquisitions in the medical sector.

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

No, I have to qualify that. We're not only looking for smaller acquisitions, but we have said that we would like to start with some smaller ones that we easily can integrate. But we certainly also will have to look at a few larger ones.

Operator

I think that answers his question. There are no further questions at this stage, Mr. Kleisterlee.

Gerard Kleisterlee - Royal Philips Electronics - President & CEO

Thank you very much and I thank everybody for your attention. And we're always available, through our Investor Relations, to answer any follow-up questions that you might have.

Operator

Ladies and gentlemen, this concludes the Royal Philips Electronics Second Quarter Results 2005 conference call on July 18, 2005. Thank you for participating. You may now disconnect.

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