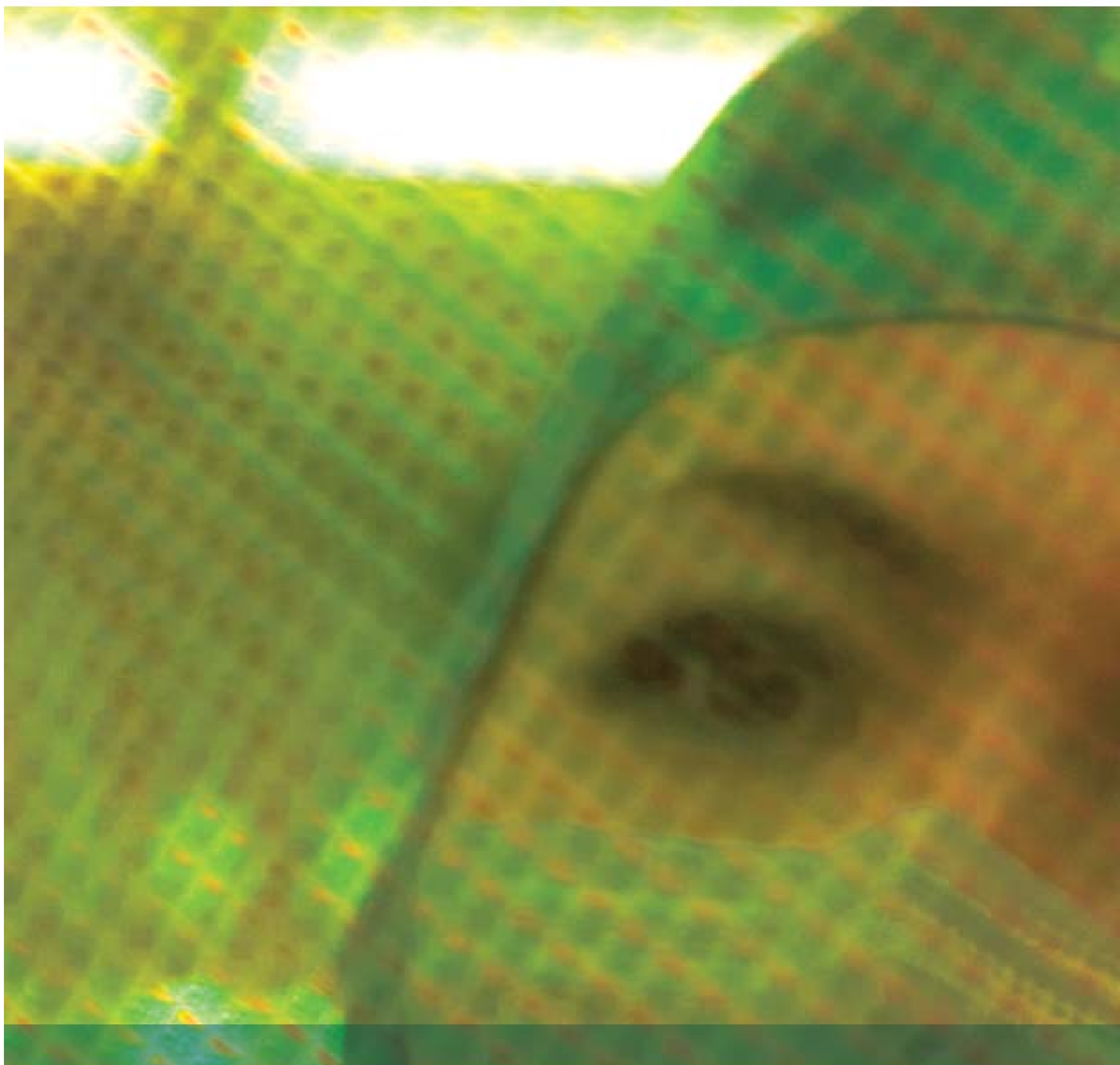

# NXP Semiconductors

Annual Report 2006

## Forward-looking statements

This document includes forward-looking statements. When used in this document, the words “anticipate,” “believe,” “estimate,” “forecast,” “expect,” “intend,” “plan” and “project,” and similar expressions, as they relate to us, our management or third parties, identify forward-looking statements. Forward-looking statements include statements regarding our business strategy, financial condition, results of operations, and market data, as well as any other statements which are not historical facts. These statements reflect beliefs of our management as well as assumptions made by our management and information currently available to us. Although we believe that these beliefs and assumptions are reasonable, the statements are subject to numerous factors, risks and uncertainties that could cause actual outcomes and results to be materially different from those projected. These factors, risks and uncertainties expressly qualify all subsequent oral and written forward-looking statements attributable to us or persons acting on our behalf and include the following:

market demand and semiconductor industry conditions, our ability to successfully introduce new technologies and products, the demand for the goods into which our products are incorporated, our ability to generate sufficient cash or raise sufficient capital to meet both our debt service and research and development and capital investment requirements, our ability to accurately estimate demand and match our production capacity accordingly or obtain supplies from third-party producers, our access to production from third-party outsourcing partners, and any events that might affect their business or our relationship with them, our ability to secure adequate and timely supply of equipment and materials from suppliers, our ability to avoid operational problems and product defects and, if such issues were to arise, to rectify them quickly, our ability to form strategic partnerships and joint ventures and successfully cooperate with our alliance partners, our ability to win competitive bid selection processes to develop products for use in our customers’ equipment and products, our ability to successfully establish a brand identity, our ability to successfully hire and retain key management and senior product architects; and, our ability to maintain good relationships with our suppliers.

Except for any ongoing obligation to disclosure material information as required by the United States federal securities laws, we do not have any intention or obligation to update forward-looking statements after we distribute this document. In addition, this document contains information concerning the semiconductor industry, our market segments and business units generally, which is forward-looking in nature and is based on a variety of assumptions regarding the ways in which the semiconductor industry, our market segments and product areas will develop. We have based these assumptions on information currently available to us. If any one or more of these assumptions turn out to be incorrect, actual market results may differ from those predicted. While we do not know what impact any such differences may have on our business, if there are such differences, our future results of operations and financial condition, and the market price of the notes, could be materially adversely affected.

## Use of non-US GAAP information

In presenting and discussing the NXP Semiconductors Group’s financial position, operating results and cash flows, management uses certain non-US GAAP financial measures. These non-US GAAP financial measures should not be viewed in isolation as alternatives to the equivalent US GAAP measure(s) and should be used in conjunction with the most directly comparable US GAAP measure(s).

## Use of fair value measurements

In presenting the NXP Semiconductors Group’s financial position, fair values are used for the measurement of various items in accordance with the applicable accounting standards. These fair values are based on market prices, where available, and are obtained from sources that we consider to be reliable. Users are cautioned that these values are subject to changes over time. When a readily determinable market value does not exist, we estimate fair values using valuation models. These require management to make significant assumptions with respect to future developments which are inherently uncertain and may therefore deviate from actual developments. In certain cases independent valuations are obtained to support management’s determination of fair values.

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# Financial highlights

all amounts in millions of euros unless otherwise stated

| | PREDECESSOR | | | **SUCCESSOR** | **COMBINED** |
|---|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 – December 31,** | **For the year ended December 31,** |
| | 2004 | 2005 | 2006 | **2006** | **2006** |
| Sales | 4,823 | 4,766 | 3,770 | **1,190** | **4,960** |
| Income (loss) from operations (Earnings Before Interest and Tax - EBIT) | 234 | 102 | 139 | **(779)** | **(640)** |
| as a % of sales | 4.9 | 2.1 | 3.7 | **(65.5)** | **(12.9)** |
| Earnings before interest, tax and amortization (EBITA) [1] | 305 | 132 | 111 | **(145)** | **(34)** |
| as a % of sales | 6.3 | 2.8 | 2.9 | **(12.2)** | **(0.7)** |
| Earnings before interest, tax, depreciation and amortization (EBITDA) [1] | 1,069 | 881 | 563 | **26** | **589** |
| as a % of sales | 22.2 | 18.5 | 14.9 | **2.2** | **11.9** |
| Adjusted EBITDA [1] | 1,202 | 1,030 | 707 | **214** | **921** |
| as a % of sales | 24.9 | 21.6 | 18.8 | **18.0** | **18.6** |
| Net income (loss) | 14 | (101) | 5 | **(616)** | **(611)** |
| Cash flows before financing activities [1] | 388 | 434 | 11 | **108** | **119** |
| Business' and Shareholder's equity | 1,458 | 1,126 | 1,977 | **3,685** | **3,685** |
| Net debt: group equity ratio [1] | - [2] | - [2] | - [2] | **48:52** | **48:52** |
| Employees at end of period | 32,580 | 35,637 | 38,144 | **37,468** | **37,468** |

1) For a reconciliation to the most directly comparable US GAAP measures, see chapter Reconciliation of non-US GAAP information under "Management discussion and analysis".

2) Information on net debt and business' equity of predecessor period is not meaningful.

### NXP Semiconductors, First Annual Report, 2006

Dear Stakeholder,

I am happy to present the first Annual Report of our company at the beginning of its new life as NXP Semiconductors. I like to say that NXP combines the vigor of a start-up enterprise with the heritage of over 50 years of experience as a strong semiconductor company within the Philips Group.

It has been a momentous year for us.

In December 2005, Royal Philips announced it had decided to separate its Semiconductors division from the rest of its business and consider all options for its future. In August 2006, a consortium of private equity investors comprised of Kohlberg Kravis Roberts & Co, Bain Capital, Silver Lake Partners, Apax Partners and Alpinvest agreed to acquire a controlling interest in Philips Semiconductors. As management, we are delighted with this move. Subsequently, on September 1, 2006 we officially launched our new company under the name NXP Semiconductors and completed our separation from Philips later that month. The launch and the new company name and identity generated a lot of excitement with our employees, customers, analysts and the media.

The spin-out of NXP, which is effected as per September 29, 2006 is supported by our confidence in our innovative capabilities, our people and customers, as well as by the NXP core values. These four values – Insightful, Inventive, Engaging, Excellence – are more than just a set of business principles; they reflect a culture shift in our company. They are also the foundation for developing a talented, motivated and committed workforce.

As a stand-alone company, NXP has every opportunity to realize its full potential. With the support of our investors, we will continue to innovate, providing our customers with leading-edge solutions and products that drive profitable growth.

We are proud of our achievements as a dynamic and global team that has already made great strides forward through hard work, consistently clear focus, and an increasingly manifest mindset of excellence. All in all, we made significant progress towards achieving our ambitions to be a leading semiconductor company in our focus markets: Mobile & Personal, Home, Automotive, Identification and MultiMarket Semiconductors.

## Our vision and strategy

Our vision is of a world where everyone can always connect to information, entertainment and services: the world of the ‘connected consumer’. Our mission is to become the leader in vibrant media technologies that help engineers and designers develop products that deliver better sensory experiences for these consumers. In short, we like to think of NXP as ‘Creating the Next Experience’. Our businesses target applications in the home electronics, mobile communications, personal entertainment, automotive and identification markets.

We address these through three distinct Business Units: Mobile & Personal, Home and Automotive & Identification. Our fourth Business Unit, MultiMarket Semiconductors provides standard products and application specific standard products for broad market applications.

We aspire to be industry leader in each of these markets, while continuing to grow revenue, profitability and cash flow. To achieve this, we see three fundamental value creation drivers at work:

1. active portfolio management targeting #1 and #2 leadership positions in focus areas
2. above-GDP semiconductor market growth and market share growth
3. operational excellence through Business Renewal.

To meet these goals, we have adopted our business renewal strategy

We launched our Business Renewal Program in 2005, stating our winning ambitions as a company and defining the roadmap to get us there. The Business Renewal Program emphasizes focus and performance, executed by a simplified, flexible organization. Its driving thrust is to achieve sales growth, enhance margins, lower operating costs, and reduce volatility, resulting in a more predictable, stable EBITA of between 5% and 15% throughout the semiconductor cycle. It should be noted that while we were a division of Philips, this target was originally formulated as percentage of EBIT.

The main steps includes:

- *Build on our market leadership positions*

We continue to invest significantly in our product portfolio, with a focus on innovations in our more profitable and faster growing segments. We will exploit our strengths in 'connected consumer' markets, particularly in home and personal entertainment, mobile communications, identification and the automotive applications. We aim to extend our competitive advantage by offering differentiated system solutions that leverage our broad range of competencies. We believe that industry consolidation will take place in the forthcoming years. We intend to play an active role in this process using strict criteria for return on investment and financial discipline.

- *Deepen our relationships with our key customers*

We will maintain the focus on our top 50 customers, which represent about 70% of our sales. We have installed dedicated account teams that work across regions in order to better match our customers' geographical diversity. We aim to further deepen our customer relationships by providing high value system solutions and by increasing the amount of collaborative design work that we conduct with our customers.

- *Improve operational excellence*

As part of the Business Renewal Program, we look to reduce costs in manufacturing, selling, general and administrative activities, increase the effectiveness of research and development, manufacturing and supply chain performance, time-to-market of new products and product quality and customer service.

- *Extend our asset-light manufacturing strategy*

We believe that our asset-light strategy will further reduce the fixed component of our cost structure, increase our return on invested capital and improve our operational flexibility throughout the industry cycle. Over the next several years, we expect to significantly increase the proportion of our semiconductor wafer production that is outsourced. At the same time it will also ensure our continued access to world-class manufacturing capacity and leading-edge process technology.

## Where we are today

The individual steps of the roadmap have been translated into specific actions that formed the backbone of our management agenda in 2006 and culminated in our successful spin-out last fall. These actions have already returned measurable results as we have exceeded our annual cost reduction target of EUR 250 million by the end of 2006, compared to the 2004 levels we use as a benchmark. Furthermore customer ratings have improved and our portfolio is now more focused. We believe that we will continue to realize significant benefits from the ongoing implementation of this program.

The positive trend in our financial performance that started in 2005, continued in 2006. This, together with satisfactory results from our Business Renewal Program, was clearly reflected in faster-than-market growth (excluding discontinued activities) for the first time in several years.

Sales in 2006 totaled approximately EUR 5 billion, up 5% as compared to 2005 on a currency comparable basis and 9% comparable growth in continued businesses. The comparable market growth was 8%. At the end of the year the industry slowed down as a result of an inventory correction. Excluding the purchase accounting effects, EBIT was EUR 150 million in 2006 compared to EUR 102 million in 2005.

While we already have leadership positions in about 60% of our product lines, we still have work to do in strengthening some of our businesses. Notably we are not yet satisfied with the progress in our Home business where we see a delay in reaching profitable operations.

## Where we are heading – Management agenda 2007

Despite the more challenging environment for the semiconductor industry from the fourth quarter of 2006 onwards, we are pleased with the overall progress we have made in 2006, and in particular the completion of our move towards being a stand-alone company. The Business Renewal Program will be continued throughout 2007 with added focus and acceleration.

The main elements of the program to achieve our objectives in 2007 are:

1. the development of a high-performance organization, staffed by inspired talented people
2. further lower our operating cost and manufacturing break-even point.
3. continue to strive for greater operational excellence through our zero defect, time to market and high yield programs.
4. achieve even more effective use of our assets, lowering depreciation and capital expenditure.
5. outperform market growth, in our key focus areas through strong engagement with our customers.
6. strengthen our business portfolio management and create stronger, more insightful value propositions.

We are making rapid progress with the execution of our programs.

We are taking swift action to execute on our strategy. We sent out a clear signal of this in February 2007, when we announced that we had agreed to acquire Silicon Laboratories' Cellular Communications Business, strengthening NXP's mobile solutions offering.

Further on our operational excellence and asset light strategy we are also making substantial progress. We have announced that we will pursue a new path in our future development of advanced CMOS process technology together with TSMC and end our involvement with the Crolles Alliance as per the end of 2007. We expect this to result in significant process R&D savings, capital expenditure reductions and cash flow from the sale of equipment. In addition, this will allow us to benefit from scale advantages with TSMC in the future.
We also announced in February 2007 that NXP will team up with Advanced Semiconductor Engineering of Taiwan to form a joint venture for IC testing and packaging in Suzhou, China.

Other strategic decisions taken in early 2007 also point to how seriously we are pursuing the need for continued speed and excellence in the execution of our Business Renewal Program.

We have made sizeable investments in our Dongguan Assembly plant and will continue to invest to increase manufacturing output of our MultiMarket Semiconductors business unit.

We also took significant measures to improve our cost base in Europe including, among others, the closure of our Böblingen operation in Germany, reorganizing our back-end operations in the Philippines and the reorganization of our Nijmegen- and Eindhoven-based operating subsidiaries in the Netherlands. We have also taken measures to strengthen our sales operations through the transformation of the European sales set up and through various new leadership appointments, notably in Asia.

And finally we are stepping up our efforts in R&D, and R&D effectiveness, in order to create insightful and innovative roadmaps of great propositions to our customers. We see that this is rewarded with several important design wins.

At the heart of all of these changes is our focus on strengthening our business to become more competitive for the future.

## A vibrant future

We look forward with enthusiasm and confidence to the opportunities of the coming years. We believe we have the talent and tools to meet the challenges we will face and to do what we know how to do best.

In conclusion, we would like to thank all of our employees for the achievements we made in 2006. We would also like to thank our private equity investors and holders of our bonds who, by funding our company and through their supportive engagement, show confidence in the future of NXP. In particular I would also like to thank our customers, for their continued trust, and for their openness and willingness to engage with us in our process of renewal and rebirth. We will have a vibrant future!

Frans van Houten
*President and CEO NXP Semiconductors*

# Information on the NXP Group

## Structure

NXP B.V. (the 'Company' or 'NXP') is the parent company of the NXP Group (the 'NXP Group' or the 'Group'). The NXP Group in its current form was established on September 29, 2006, when Koninklijke Philips Electronics N.V. ("Philips") sold 80.1% of its semiconductors businesses to a consortium of private equity investors in a multi-step transaction. In order to carry out this transaction, Philips transferred these businesses to NXP on September 28, 2006. All of our issued and outstanding shares were then acquired September 29, 2006 by KASLION Acquisition B.V. which was formed as an acquisition vehicle by the private equity consortium and Philips.

The management of the Company is entrusted to the Board of Management under the supervision of the Supervisory Board. Under the chairmanship of the CEO, the Board of Management has overall operational responsibility for the management of the Company, the deployment of its strategy and policies, and the achievement of its objectives and results. The Board of Management is accountable for its performance to our Supervisory Board and our shareholders. The Executive Management Team, which consists of the members of the Board of Management as well as eight senior executives of the Company, is responsible for ensuring business issues and practices are shared across our business. This Annual Report contains:

1. The consolidated financial statements of NXP B.V. based on US GAAP
2. The consolidated financial statements of NXP B.V. based on IFRS as endorsed by the E.U., and
3. The statutory financial statements of NXP B.V., using IFRS accounting principles as endorsed by the E.U. in accordance with Part 9 of Book 2 of the Netherlands Civil Code.

## Business overview

The NXP Group is one of the world's largest semiconductor companies. With total sales of approximately EUR 5 billion in 2006, it ranks among the world's top ten semiconductor providers and among the top three suppliers of application-specific semiconductors in terms of total sales. With over 50 years of operating history, we are also one of the longest-established companies in our industry. Our business targets the home electronics, mobile communications, personal entertainment, automotive and identification application markets. Within these markets, we provide a diversified range of application-specific semiconductors, including system solutions, and semiconductor components. We also have a strong MultiMarket products business, which provides our customers with general purpose semiconductor components, including transistors and diodes, general purpose logic and power discretes as well as an array of application specific standard products.

## Strategy

Our vision is to be a leading semiconductor supplier in a world where consumers connect to information, entertainment and services through electronic devices containing our system solutions. We aspire to be industry leaders in the markets for our Mobile & Personal, Home, Automotive & Identification and MultiMarket Semiconductors business units, and to continue to grow revenue, profitability and cash flow. In order to meet these goals, we have adopted the strategies described below:

- *Build on our market leadership positions.*

We believe that our market leadership positions, extensive intellectual property and strong research and development organization provide us with a strong foundation from which to gain additional market share in our targeted markets. We intend to build on this foundation by continuing to invest in our product portfolio, with a focus on innovations in our more profitable and faster growing segments. We look to exploit our strengths in connected consumer markets, particularly in home and personal entertainment mobile communications, identification and the automotive applications. We aim to extend our competitive advantage by offering differentiated system solutions that leverage our broad range of competencies. We believe that industry consolidation will take place in forthcoming years. We intend to play an active role in this process using strict criteria for return on investment and financial discipline. For example, on February 8, 2007, we announced the anticipated acquisition of the Cellular Communications Business of Silicon Laboratories Inc, which we believe will strengthen our position in the key mobile phone business. The assets we will acquire include RF CMOS technology-based transceivers for cellular phones, as well as monolithic cellular systems chips.

- *Deepen our relationships with our key customers.*

We intend to increase our share of the semiconductors purchased by our customers, with a particular focus on our top 50 customers. To realize this objective, we have redeployed our sales and marketing resources to target these top customers more effectively. We have created dedicated account teams that work across regions in order to better accommodate our customers' increasing geographical diversity. We seek to deepen our customer relationships by continuing to provide high value systems solutions and by increasing the amount of collaborative design work that we conduct with our customers.

- *Improve operational excellence.*

In 2005, we launched our Business Renewal Program, a comprehensive multi-year performance improvement program intended to drive revenue growth and increase profitability. As part of this program, we look to reduce costs in manufacturing, selling, general and administrative activities, increase our effectiveness in research and development, and improve our organizational efficiency, manufacturing and supply chain performance, time-to-market of new products, product quality, customer service and attain market leadership positions in our product portfolio.

- *Extend our asset-light manufacturing strategy.*

We will continue to pursue our asset-light manufacturing strategy. Over the next years, we expect to significantly increase the proportion of our semiconductor wafer production that is outsourced. In particular, we plan to utilize third party foundries for a substantial part of the future growth in our manufacturing requirements. For assembly and test processes, we expect to maintain current outsourcing levels, as we believe that our in-house facilities are highly competitive in terms of quality and cost. We believe that our asset-light strategy will further reduce the fixed component of our cost structure, increase our return on invested capital and improve our operational flexibility throughout the industry cycle, while also ensuring our continued access to world-class manufacturing capacity and leading-edge process technology.

## Business activities

The products sold by our four business units fall into two categories. The first category consists of highly differentiated application-specific semiconductors and system solutions. Our Mobile & Personal, Home and Automotive & Identification business units primarily sell products in this category. The profitability of these products depends to a significant degree on our ability to innovate and develop new technologies and customer solutions.

The second of our product categories comprises of standard products, which are devices that can be incorporated in many different types of electronic equipment and which are typically sold to a wide variety of customers, both directly and through distributors. Our MultiMarket Semiconductors business unit carries a large number of standard products, in addition to application specific standard products. The profitability of standard products tends to be driven by manufacturing cost, supply chain efficiency and continuous improvement of manufacturing processes.

Across all four of our business units, we leverage both our knowledge of the consumer and our particular technical expertise in the areas of audio, video, radio frequency communications, power management and security technologies to create and deliver semiconductor solutions for the connected consumer.

## Business Units

### Mobile & Personal

Our Mobile & Personal business unit provides application-specific semiconductors, selected components and complete system solutions for use in mobile and portable devices, such as cellular handsets, portable media players and cordless phones. The convergence of cellular handsets and portable entertainment devices is creating demand for solutions enabling the delivery of multimedia content over wireless networks. As a result, multimedia handsets are incorporating increasing functionality, including application processing, video processing, wireless connectivity, and other personal entertainment technologies. The increasing prevalence and complexity of semiconductors within a given handset device, especially those which enable multimedia connectivity, is driving growth in this sector. Our television-on-mobile, FM radio and mobile USB products are part of our strategic focus on the devices and technologies that we expect to gain increasing importance as voice and multimedia capabilities converge in the mobile market. Our key customers in Mobile & Personal include Apple, Nokia, VTech, Samsung and Sony Ericsson.

### Home

Our Home business unit provides system solutions for the analog and Digital TV (DTV), STB and PC-TV application markets, as well as related semiconductor components. Our products are well positioned to meet the demands of the connected consumer for multimedia access in the home. We hold leading positions in the DTV, set-top box and PC-TV application markets, which in large part have grown because of our leadership in the analog television market, where NXP is one of the top suppliers of semiconductors globally. Part of the growth in these markets is driven by government mandates requiring the inclusion of a digital tuner in every new television, increasing broadband penetration and the increasing availability of high definition content. The DTV semiconductor market in particular is expected to grow at a rapid rate as a result of increasing product complexity and increasing unit sales.

As DTV technology becomes more complex, we expect that traditional DTV OEMs will look to semiconductor vendors who can provide a competitive total system solution. Our total system solution for the DTV application market positions us well to benefit from this growth. In addition, as the consumer market becomes more digitized and as the mobile device market becomes increasingly multimedia enabled, we are able to leverage technologies from our Mobile & Personal business unit to gain an advantage over many of our key competitors. Our key customers in Home include LG Electronics, Sony, Sharp, Philips and Dell.

## Automotive & Identification

Our Automotive & Identification business unit provides system solutions and semiconductor components for the automotive and identification application markets.

In our Automotive business, we provide semiconductor products used in the in-car entertainment, in-vehicle networking, car access and immobilizer systems, and tire pressure monitoring application markets and automotive safety and comfort applications. The market for automotive semiconductors has grown consistently and at a higher growth rate over the recent years than the overall semiconductor market, despite relatively slow growth in the sales of automobiles. This is due to the increasing prevalence of semiconductor devices within vehicles, which in turn has been the result of the further integration of consumer electronics in cars, an increasing focus on consumer safety and comfort and the replacement of mechanical devices with semiconductors in order to meet more demanding safety, reliability, weight and power-reduction requirements. The emergence of more integrated, "smart" safety and security systems, which utilize combinations of sensors, in-vehicle networks, microcontrollers and power management components, favor a broad automotive portfolio such as the product lines we currently maintain. We are able to leverage technology and experience from our Mobile & Personal and Home business units to develop analogous in-car devices, such as car information and entertainment solutions. We believe that significant barriers to entry in the automobile market, such as long product lifecycles and zero defects requirements of automotive manufacturers, also give us a competitive advantage.

Our Identification business has played an important role in creating the markets for Radio Frequency Identification (RFID), eGovernment and Near-Field Communication technologies. The primary factors driving growth in these markets are new governmental requirements for secure identity documents, the increasing prevalence of cashless transactions and more sophisticated supply chain management models. Our innovation programs have allowed us to achieve a leading market position in each of these application markets. We have focused on complex and high-margin areas of the identification market. For example, in smart cards, we have elected not to participate in the largely commoditized segments of the SIM and banking card market, but emphasizing instead the high-security, higher value-added segments. RFID, where we have an early market lead, is expected to show strong growth. Our key customers in Automotive & Identification include Bosch, Gemalto, Siemens VDO, Sony and Visteon.

## MultiMarket Semiconductors

Our MultiMarket Semiconductors business unit supplies a broad range of standard products and Application Specific Standards Products, including standard and specialty logic devices, discrete semiconductors, analog and mixed signal components and a broad range of microcontrollers.

Many of the standard products we make in our MultiMarket Semiconductors business unit, such as transistors, diodes, power control devices and general purpose logic devices, are offered by a variety of companies. A large part of sales of these products flow through distribution channels. Differentiation is achieved through portfolio, availability, customer service and costs. In addition to these, we also provide a range of application-specific standard products, including microcontrollers and radio frequency devices.

The discrete semiconductor production unit reports directly to the MultiMarket semiconductor business unit, while the integrated circuit parts are produced within the IC Manufacturing Operations unit.
Our key customers in MultiMarket Semiconductors include distributors Avnet, Arrow, Future and WPI, as well as OEMs such as Nokia, Samsung and Philips.

Our MultiMarket Semiconductors operations include our stake in Jilin NXP Semiconductor Ltd. (JNS). JNS is a joint venture based in China that we operate in collaboration with Jilin Sino-Microelectronics Co. Ltd. (JSMC). We currently hold a 60% ownership interest in JNS, and JSMC holds the remaining 40%. JNS was founded in 2003 and manufactures bipolar discrete power products.

## IC Manufacturing Operations (IMO)

We manufacture integrated circuits and discrete semiconductors. The manufacturing of our integrated circuit products is managed centrally by our IMO division, which serves as an integrated source for integrated circuit fabrication, test and packaging for each of our four business units. The integration of our integrated circuit manufacturing operations across all four business units permits us to reduce the volatility in production demand that would result from independent operations. Our MultiMarket Semiconductors unit, which uses on IMO for most of the integrated circuits it sells, operates its own dedicated wafer fabrication and test and packaging facilities, primarily for discrete semiconductors. Our IMO and MultiMarket Semiconductors operations include facilities wholly owned by us, as well as partial interests in certain facilities. Our IMO operations also coordinate our usage of third party foundries and assembly and test subcontractors. We currently meet a majority of our production requirements with our in-house facilities. However, as part of our asset-light strategy, we intend to significantly increase the proportion of our front-end wafer production that is outsourced or conducted through joint venture operations.
The manufacturing of a semiconductor involves several phases of production, which can be broadly divided into "front-end" and "back-end" processes. Front-end processes take place at highly complex wafer manufacturing facilities and involve the imprinting of substrate silicon wafers with the precise circuitry required for semiconductors to function. The front-end production cycle requires high levels of precision and involves as many as 300 process steps. Back-end processes involve the assembly, test and packaging of semiconductors in a form suitable for distribution.

Our IMO business unit includes the operations of Systems on Silicon Manufacturing Co. Pte. Ltd. (SSMC), which we own jointly with TSMC. In November 2006, we increased our shareholding in SSMC from 50.5% to 61.2%. SSMC is a leading manufacturer of CMOS-based semiconductors, using process technologies to make wafers with line widths down to 140 nanometers. SSMC is one of the larger eight-inch CMOS wafer fabs in the industry. SSMC is our fully-owned eight-inch wafer CMOS capability and allows us to jointly develop and share technological advances with TSMC.

## Other Business Activities

Certain of our business activities are reported outside of our primary business units. These include:

*Software Solutions.*
Our Software Solutions business develops audio and video multimedia solutions that enable mobile device manufacturers to quickly produce differentiated hand-held products that enhance the end-user experience. Its software has been incorporated into over 100 million mobile devices produced by many of the world's leading mobile device manufacturers. It is particularly focused on partnerships with the top OEM handset manufacturers, as well as on specific integrated circuit-based products, such as our Nexperia product line, which integrates software and hardware solutions in a system-on-chip design.

*IP Licensing.*
We license and cross-license our intellectual property to semiconductor companies and other technology firms. Apart from the revenues these licensing activities generate, we also view active intellectual property licensing as an important means to promote our businesses and technologies. Our cross-licensing activities are typically conducted with other large semiconductor companies, who have resources and research and development activities similar to ours.

*Emerging Semiconductors Businesses.*
Our Emerging Business unit focuses on growing innovative early-stage businesses in solid-state lighting applications. Through this unit, we seek to leverage our existing customer relationships, technologies and industry position to create growth opportunities for the future.

## Global Sales and Marketing

We market and sell our products worldwide to a variety of OEMs, original design manufacturers, contract manufacturers and distributors. We focus on generating demand for our products using our long-standing customer relationships and providing high quality customer support.

Our sales and marketing organization is divided into four key sales regions and four global functions. Our sales and marketing teams in each sales region, which are Europe, the Americas, Greater China and Asia Pacific, are responsible for managing the global key account teams for customers headquartered in that region as well as for managing regional sales to non-key accounts.
Our global functions are divisional marketing, channel management, alliance and partnership management and global support operations. Each of these global functions is managed by our central sales and marketing office, which is located at our headquarters in Eindhoven, The Netherlands. Our sales and marketing strategy focuses on building lasting relationships with our customers and becoming their preferred supplier, which we believe assists us in reducing sale volatility in difficult markets. When we target new customers, we generally focus on companies that are leaders in their markets.

## Research & Development

Our research and development activities are critical to our success. We conduct both product-specific and process technology research and development. Our product specific research and development, which constitutes the majority of our research and development expenditures, is primarily aligned with our four business units. Our process technology research and development is conducted centrally and seeks to develop improved semiconductor fabrication technologies that can be utilized by all of our business units.

## Alliances and investments

We participate in a number of alliances with respect to technology development and manufacturing. These alliances are a part of our asset-light strategy, since they enable us to reduce fixed costs associated with manufacturing and development activities and to share research and development expenses with third parties. Apart from JNS and SSMC, which are described above, we participate in the following alliances.

*Advanced Semiconductor Manufacturing Company*

We established the Advanced Semiconductor Manufacturing Company (ASMC) in Shanghai in 1995 in partnership with a number of Chinese joint venture partners. ASMC currently operates three wafer fabs, producing five-, six- and eight-inch wafers of primarily analog integrated circuits using CMOS and bipolar process technologies. We use ASMC to supplement our in-house capacity for analog integrated circuits with line widths in the 0.35 to 3 micron range. We currently beneficially own 27% of the outstanding shares of ASMC, which are publicly traded on the Hong Kong Stock Exchange. Delivery has not yet occurred, due to delay in the approval process of local authorities.

*Crolles Alliance*

Crolles is a research and manufacturing alliance among NXP, ST Microelectronics and Freescale based in Crolles, France. On January 16, 2007 we announced that we will not extend our current cooperation in the Crolles Alliance beyond the initial term, which expires at the end of 2007. We have decided to pursue a different path for our future development of process technology, through greater cooperation with TSMC. NXP will work together with the Alliance partners in 2007 to complete the current program on 45nm CMOS and effectively manage the transition.

*T3G*

In January 2003, Datang Mobile, Philips Semiconductors and Samsung Electronics formed a joint venture, namely T3G Technology Co. Ltd., to design and license system solutions for mobile devices. In January 2005, Motorola joined as a new partner with additional investment. Currently NXP has a 42.7 % share in T3G. The collaboration combines NXP's cutting edge semiconductor design and process capability, Datang's TD-SCDMA expertise and Samsung's and Motorola's leadership in mobile handset creation. TD-SCDMA is a China homegrown, international 3G standard, with strong support from the Chinese government. This support will virtually ensure the success of TD-SCDMA as one of the 3G standards in China, the world's largest market for mobile phones. TD-SCDMA has now reached a good level of maturity. NXP will use the TD-SCDMA IP, as developed by T3G, in its product offerings in order to strengthen the value proposition to its own customers.

*Software Partnerships*

In addition to manufacturing and process technology research, we leverage strategic partnerships to develop software for our products. As our market focus turns increasingly towards system solutions, software is playing a critical role in determining our competitiveness. By partnering with independent software developers, we gain the benefit of industry-leading expertise and quality levels with respect to the software which operates on our products. In return, our partners, who currently include approximately 100 software companies, gain a platform with which to align their software.

## Board of Management

Under the chairmanship of the CEO, the Board of Management has overall operational responsibility for the management of the Company, the deployment of its strategy and policies, and the achievement of its objectives and results. The Board of Management, working closely with NXP's Executive Management Team, is responsible for carrying out the day-to-day operations of the business, including the development of business plans, budgets and operational forecasts. Major decisions of the Board of Management require the approval of the Supervisory Board, including decisions relating to the Company's operational and financial objectives and the strategies it uses to achieve those objectives.
Set forth below is a list of the members of the Board of Management along with their year of birth and nationality:

***Frans van Houten, 1960, Dutch***
Mr. van Houten is Chairman of the Board of Management, President and Chief Executive Officer.

***Peter van Bommel, 1957, Dutch***
Mr. van Bommel is a member of the Board of Management, Executive Vice President and Chief Financial Officer.

***Theo Claasen, 1945, Dutch***
Mr. Claasen is a member of the Board of Management, Executive Vice President, Strategy and Business Development.

***Hein van der Zeeuw, 1954, Dutch***
Mr. van der Zeeuw is a member of the Board of Management, Executive Vice President and General Manager of MultiMarket Semiconductors.

## Executive Management Team

The Executive Management Team is responsible for ensuring business issues and practices are shared across our businesses. The Executive Management Team consists of the members of the Board of Management, as well as eight senior executives of the Company.
Set forth below is a list of the members of the Executive Management Team, other than the members of the Board of Management along with their year of birth and nationality:

***Ajit Manocha, 1950, American***
Mr. Manocha is Executive Vice President and Chief Manufacturing Officer.

***Marc de Jong, 1961, Dutch***
Mr. de Jong is Executive Vice President and General Manager of the Automotive & Identification business unit.

***Gert-Jan Kaat, 1952, Dutch***
Mr. Kaat is Senior Vice-President and General Manager of the Mobile & Personal business unit.

***Giel Rutten, 1957, Dutch***
Mr. Rutten is Senior Vice-President and General Manager of the Home business unit.

***Rene Penning De Vries, 1954, Dutch***
Mr. Penning De Vries is Senior Vice President and Chief Technology Officer.

***Pascal Langlois, 1960, French***
Mr. Langlois is Senior Vice President, Global Sales.

***Peter Kleij, 1960, Dutch***
Mr. Kleij is Senior Vice President, Human Resource Management.

***Guido Dierick, 1959 , Dutch***
Mr. Dierick is Senior Vice President, Legal and IP and General Counsel.

## Supervisory Board

The Supervisory Board has comprehensive oversight responsibilities and supervises and advises the Board of Management in performing its management tasks and setting the direction of NXP's business. It approves major management decisions, including the overall business strategy, and supervises the structure and management of the Company's internal control systems and the financial reporting process. It also determines the remuneration of the individual members of the Board of Management within the established remuneration policy.
While retaining overall responsibility, the Supervisory Board assigns certain of its tasks to three permanent committees: the Operating Committee, the Nominating and Compensation Committee and the Audit Committee.
Set forth below is a list of the members of the Supervisory Board and their committee membership along with their year of birth and nationality:

***Sir Peter Bonfield, 1944, British***
Sir Peter is the chairman of the Supervisory Board.

***Johannes P. Huth, 1960, German***
Mr. Huth is a vice-chairman of the Supervisory Board and Managing Director of KKR Europe [1) 2)].

***Adam H. Clammer, 1970, American***
Mr. Clammer is a member of the Supervisory Board and representing KKR.

***Eric Coutinho, 1951, Dutch***
Mr. Coutinho is a member of the Supervisory Board and Chief Legal Officer of Royal Philips Electronics.

***Egon Durban, 1973, German***
Mr. Durban is a member of the Supervisory Board and Managing Director of Silver Lake [1) 3)].

***Ian Loring, 1966, American***
Mr. Loring is a member of the Supervisory Board and Managing Director of Bain Capital Partners.

***Michel Plantevin, 1956, French***
Mr. Plantevin is a member of the Supervisory Board and Managing Director of Bain Capital Partners [1) 2)].

***Christian Reitberger, 1968, Austrian***
Mr. Reitberger is a member of the Supervisory Board and Apax Partners [1) 3)].

1) Member of the Supervisory Board Operating Committee

2) Member of the Supervisory Board Nominating and Compensation Committee

3) Member of the Supervisory Board Audit Commitee

## General

The supervision of the general affairs and business of NXP B.V. (the 'Company') is entrusted to the Supervisory Board, which, in the two-tier corporate structure under Dutch law, is a separate body, fully independent of the Board of Management. This independence is reflected in the requirement that members of the Supervisory Board be neither members of the Board of Management, nor employees of the Company. The Supervisory Board supervises and advises the Board of Management in performing its management tasks and setting the direction of the Company's business. Similar to the Board of Management, it is guided by the interests of the Company and its business, taking into account the relevant interests of the stakeholders involved in the Company. The Supervisory Board discusses and approves the Company's corporate strategy, it approves major management decisions, including the overall business strategy, and supervises the structure and management of internal control systems and the financial reporting process. The Supervisory Board also determines the remuneration of the individual members of the Board of Management. While retaining overall responsibility, the Supervisory Board assigns certain of its tasks to three permanent committees: the Operating Committee, the Nominating and Compensation Committee and the Audit Committee.

The Supervisory Board was installed on September 29, 2006, immediately following the acquisition of a majority interest in the Company by a consortium of private equity investors (the Consortium). The Supervisory Board consists of eight members, six of whom are nominated by the Consortium, one of whom is nominated by Philips and one of whom is an independent chairperson. The members of the Supervisory Board are listed on page 17 of this Annual Report.

The Supervisory Board met one time in the course of 2006. The members of the Board of Management were present at this meeting. The Supervisory Board was informed and consulted by the Board of Management on the direction of the Company's business and passed several resolutions. In addition to this meeting, the Chairman and other members of the Supervisory Board had regular contact with the CEO and other members of the Board of Management.

## Operating Committee

The Operating Committee is responsible for maintaining regular contact with the Board of Management on the implementation of the Company's budget and group strategy. It conducts regular business reviews, supervises the Company's general affairs, and advises the Board of Management and Executive Management Team. The Committee met three times in the course of 2006 and reported its findings to the plenary Supervisory Board. The members of the Operating Committee are Messrs. Huth (Chairman), Durban, Plantevin and Reitberger.

## Nominating and Compensation Committee

The Nominating and Compensation Committee determines selection criteria and appointment procedures for members of the Board of Management, periodically assesses the scope and composition of the Board of Management and evaluates the performance of its individual members.
It is further responsible for recommending to the Supervisory Board the compensation package for each member of the Board of Management. It reviews employment contracts entered into with members of the Board of Management, makes recommendations to the Supervisory Board with respect to major employment-related policies and overseas compliance with the Company's employment and compensation-related disclosure obligations under applicable laws. The members of the Nominating and Compensation Committee are Messrs. Huth and Plantevin. The Nominating and Compensation Committee met one time in 2006 and reported its findings to the plenary Supervisory Board.

## Audit Committee

The Audit Committee assists the Supervisory Board in supervising and monitoring, and advising the Board of Management on, the effect of internal risk management and control systems, including supervision of the Company's compliance with relevant legislation and regulations and the effect of the Company's Business Code of Conduct. It overseas the preparation of the Company's financial statements, its financial reporting process, system of internal business controls and risk management, internal and external audit process and the internal and external auditor's qualifications, independence and performance. The Audit Committee also reviews the Company's annual and interim financial statements and other public disclosures, prior to publication. The members of the Audit Committee are Messrs. Reitberger (Chairman) and Durban. The Supervisory Board considers the knowledge and experience available on the Audit Committee as well as the availability of advice from internal and external experts and advisors to be sufficient for the fulfillment by the Audit Committee of its tasks and responsibilities. The Supervisory Board has not determined that any member of the Audit Committee is an "audit committee financial expert", as such term is defined under the rules of the SEC. The Audit Committee met one time in 2006 and reported its findings to the plenary Supervisory Board.

## Replacement of Independent Registered Public Accounting Firm

While the Company was operated as a division of Philips, KPMG Accountants N.V. ("KPMG"), which is the independent registered public accounting firm for the Philips consolidated group, audited the Company and its subsidiaries. For the fiscal period commencing subsequent to the separation from Philips on September 29, 2006, Deloitte Accountants B.V. ("Deloitte") has replaced KPMG as the Company's independent registered public accounting firm. The appointment of Deloitte was proposed by the Supervisory Board and the Board of Management and approved at a general meeting of shareholders held on December 19, 2006. During the fiscal years ended December 31, 2004 and 2005 the period January 1, 2006 through September 28, 2006 and through March 22, 2007, there have been no disagreements with KPMG on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements if not resolved to the satisfaction of KPMG would have caused it to make reference thereto in its reports on our financial statements for such periods. During 2006, the Company consulted Deloitte with respect to the preparation of pro forma data in connection with the acquisition.

## Audited Financial Statements

The combined financial statements of the Company (Predecessor) for the years ended December 31, 2004 and 2005 and the period from January 1, 2006 to September 28, 2006 included in this Annual Report, as presented by the Board of Management, have been audited by KPMG Accountants N.V., independent registered public accounting firm. The consolidated financial statements of the Company (Successor) for the period from September 29, 2006 to December 31, 2006 and as of December 31, 2006 included in this Annual Report, as presented by the Board of Management, have been audited by Deloitte Accountants B.V., independent registered public accounting firm. The reports of the independent registered public accounting firms appear on pages 133 and 134 of this Annual Report. We have approved these financial statements.

Finally, we would like to express our thanks to the members of the Board of Management, the Executive Management Team and all employees for their efforts and contribution during this first year for the Company.

July 18, 2007

*The Supervisory Board*

The following discussion is based on the US GAAP consolidated financial statements and should be read in conjunction with these statements and the other financial information contained herein.

## Basis of presentation

The discussion and analysis of the financial results and condition of NXP Semiconductors Group is based on the audited US GAAP financial statements of the Company for the years ended December 31, 2004 and December 31, 2005 and the period from January 1, 2006 through September 28, 2006 (Predecessor) and the period from September 29, 2006 through December 31, 2006 (Successor). This discussion should be read in conjunction with those audited financial statements, which have been included in this Annual Report.

On September 29, 2006 Koninklijke Philips Electronics N.V. ("Philips") sold 80.1% of its Semiconductors business to a consortium of private equity investors (the "Consortium") in a multi-step transaction. In order to carry out this transaction, Philips transferred these businesses to NXP B.V. on September 28, 2006 (the "Separation"). All of our issued and outstanding shares were then acquired on September 29, 2006 by KASLION Acquisition B.V. ("KASLION"), which was formed as an acquisition vehicle by the Consortium and Philips. We refer to our acquisition by KASLION as the "Acquisition".
As a result of the Separation and Acquisition, the accompanying combined and consolidated balance sheets and statements of operations, cash flows and business' and shareholder's equity are presented on two different bases: Predecessor and Successor, which relate to periods preceding the Acquisition and periods from and after the Acquisition, respectively. The basis of accounting for the Predecessor is different than that for the Successor, since the consolidated financial statements of the Successor are impacted by the effect of the purchase accounting applied to the Acquisition, which requires that all assets and liabilities be recorded at fair value. Furthermore, the combined financial statements for the Predecessor have been derived from the consolidated financial statements and accounting records of Philips, principally the historical results of operations and basis of assets and liabilities of Philips' Semiconductor businesses. The results for those periods include an allocation of the costs of certain corporate functions or expenses, historically provided or incurred by Philips, which allocations are made on a specifically identifiable basis, or other basis considered reasonable. The consolidated financial statements of the Successor represent actual costs incurred after the Acquisition as a stand-alone company. The costs allocated to the Predecessor are not always comparable to the actual costs incurred by the Successor.
Notwithstanding the difference in the basis of accounting between the Successor and Predecessor described above, we have prepared our discussion of the results of operations for the year ended December 31, 2006 based on the arithmetical combination of these results for each of the periods January 1, 2006 through September 28, 2006 (Predecessor) and September 29, 2006 through December 31, 2006 (Successor), since we believe this provides the most meaningful comparison with previous years' results. Because our accounting basis changed upon the Acquisition, however, the presentation of the combined results of our Predecessor and Successor periods does not comply with US GAAP and has not been audited. Where relevant, we have described the impact on our results of the purchase accounting used in connection with the Acquisition (see "Effect of Purchase Accounting", below) and have also provided 2006 financial results as adjusted to eliminate the impact of these accounting effects, ("Purchase Price Adjustments"(PPA)).

We have also described the impact of cost allocations to the Predecessor and the actual stand-alone costs of the Successor, where relevant to the analysis.

## Use of certain non-GAAP Financial Measures

The following non-GAAP financial measures are presented in the discussion because they are used by management in evaluating the performance of the Company and its reporting segments:

*Comparable Growth*
This represents the change in sales between periods, adjusted for the effect of fluctuations in currency exchange rates. Management believes that an understanding of sales performance is enhanced after the effects of currency movements are excluded. Where presented, 'nominal growth' represents the change in sales between periods, including the effect of currency fluctuations. Sales are translated from foreign currencies into the Company's reporting currency, the euro, at the exchange rate on transaction during the respective years.

*Earnings Before Interest and Tax (EBIT)*
EBIT as used by the Company, has the same meaning as income from operations as presented in the audited financial statements, and is used to evaluate the performance of the Company and its operating businesses.

*Earnings before Interest, Tax and Amortization (EBITA)*
EBITA represents net income excluding income taxes, financial income and expenses and amortization. EBITA is used by management to evaluate the performance of the Company and its operating business, since it believes that using EBITA facilitates the comparison between periods of the underlying performance of our businesses.

*Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA)*
EBITDA is used by management to evaluate the performance of the Company and its operating businesses, since it believes that using EBITDA facilitates the comparison between periods of the underlying performance of our businesses. EBITDA represents net income excluding income taxes, financial income and expenses and amortization and depreciation.

*Adjusted EBITDA*
Adjusted EBITDA refers to EBITDA adjusted for items such as restructuring, litigation, disentanglement costs, exit of business lines and other non operations-related items. Management also uses Adjusted EBITDA to evaluate the performance of the Company and make comparisons over different fiscal periods, since it eliminates the effect of certain items management deems less relevant to the ongoing operations of the Company.

*Cash flows before financing activities*
Cash flows before financing activities, being the sum total of net cash from operating activities and net cash from investing activities, are presented separately to facilitate the reader's understanding of the Company's funding requirements.

*Net debt : group equity ratio*
The total net debt position as a percentage of the sum of total group equity (shareholder's equity and minority interests) and net debt is presented to express the financial strength of the Company. This measurement is widely used by investment analysts and is therefore included in the disclosure.

For a reconciliation of non-GAAP financial measures to the nearest US GAAP financial measure, refer to "Reconciliation of non-US GAAP information".

## Effect of purchase accounting

Our Acquisition by KASLION has been accounted for using the purchase method. Accordingly, the EUR 8,208 million purchase price (including assumed debt) paid by KASLION to Philips (which includes acquisition costs of EUR 45 million and estimated settlement payments for differences in agreed levels of net cash and working capital of EUR 84 million), has been "pushed down" to NXP and allocated to the fair value of assets acquired and liabilities assumed.

The net tangible assets of NXP amounted to EUR 2,590 million, resulting in an excess of the purchase price over the tangible assets acquired of EUR 5,618 million. The excess of the purchase price over the net tangible assets was allocated as follows:

*Identified technology-related intangible assets:*

- Existing technology with an aggregate estimated fair value of EUR 1,606 million and useful lives varying between 3 and 12 years;
- In process research & development with an aggregate estimated fair value of EUR 515 million, which was written off in full in the period immediately following the Acquisition and charged to R&D expenses;
- Core technology with an aggregate estimated fair value of EUR 791 million and with useful lives varying between 8 and 12 years.

*Identified customer-related intangible assets:*

- Customer relationships with an aggregate estimated fair value of EUR 592 million and with useful lives varying between 14 and 16 years;
- Order backlog with an aggregate estimated fair value of EUR 47 million, which management believes to be firm and expects NXP to realize over one year.

*Trademarks:*

Trademarks with an aggregate estimated fair value of EUR 85 million, with useful lives of 5 years.

*Tangible fixed assets and inventories:*

- Tangible fixed assets EUR 422 million comprising of: Land (EUR 55 million), Buildings (EUR 197 million) and Machinery and Equipment (EUR 170 million);
- Inventories EUR 130 million.

*Other, partly offsetting above allocations, comprising of:*

- Deferred tax liabilities in respect of above purchase adjustments (EUR 461 million);
- Pension liabilities (EUR 104 million);
- Investments unconsolidated companies (EUR 10 million).

The EUR 2,005 million excess of the purchase price over the estimated fair value of the net assets acquired was allocated to goodwill. In accordance with SFAS 142 ("Goodwill and other Intangible Assets"), goodwill is not amortized but will be tested for impairment at least annually.

The above mentioned adjustments in fair values had an EBIT impact of EUR 790 million in the period from September 29, 2006 through December 31, 2006, due to increased depreciation and amortization charges. This was partly offset by the tax effect (EUR 227 million) on the purchase price adjustments.

## NXP Semiconductors Group performance 2006 compared to 2005

### Operational items

| In millions of euros | Predecessor: For the year ended December 31, 2005 | Predecessor: For the period January 1, 2006 – September 28, 2006 | Successor: For the period September 29, 2006 – December 31, 2006 | Combined: For the year ended December 31, 2006 | Combined: Effects of PPA | Combined: For the year ended December 31, 2006 (As adjusted to eliminate PPA effects) |
|---|---|---|---|---|---|---|
| Total sales | 4,766 | 3,770 | **1,190** | 4,960 | - | 4,960 |
| % nominal growth | (1.2) | 10.6 | **(12.4)** | 4.1 | | 4.1 |
| % comparable growth | (1.4) | 9.7 | **(6.9)** | 5.1 | | 5.4 |
| Gross margin | 1,833 | 1,439 | **273** | 1,712 | (155) | 1,867 |
| Selling expenses | (304) | (275 ) | **(88)** | (363) | - | (363 ) |
| General & administrative expenses | (435) | (306 ) | **(194)** | (500) | (120) | (380 ) |
| Research & development expenses | (1,028) | (737 ) | **(773)** | (1,510) | (515) | (995 ) |
| Other business income | 36 | 18 | **3** | 21 | - | 21 |
| Earnings before interest and tax (EBIT) | 102 | 139 | **(779)** | (640) | (790) | 150 |
| EBITDA | 881 | 563 | **26** | 589 | (130) | 719 |
| Adjusted EBITDA | 1,030 | 707 | **214** | 791 | (130) | 921 |

### Total sales

Total sales were EUR 4,960 million for the combined period January 1, 2006 through December 31, 2006, compared to EUR 4,766 million for 2005, an increase of 4%, or 5% on a currency comparable basis. Sales were strong in the first nine months of 2006, particularly in our MultiMarket Semiconductors and Automotive & Identification business units. Towards the end of 2006 sales declined as the industry slowed down, primarily as a result of an inventory correction at our customers.

### Gross margin

Gross margin increased from EUR 1,833 million in 2005 to EUR 1,867 million (excluding the effect of purchase accounting) in 2006. As a percentage of sales, the gross margin decreased by 1% for 2006 compared to 2005, caused by the unfavorable effect of mainly one-time cost items amounting to EUR 53 million, consisting of legal disentanglement, litigation and restructuring costs. Furthermore, the 2005 gross margin was positively affected by post-retirement benefits (FAS 106) and the release of litigation provisions.
Excluding these effects the gross margin was slightly higher in 2006, benefiting from higher utilization of our manufacturing facilities. Furthermore depreciation and amortization charges, as a result of our asset light strategy, were EUR 197 million lower for the combined period 2006 compared to 2005.

The financial impact of purchase accounting for the period September 29, 2006 through December 31, 2006 amounted to EUR 155 million and was charged to cost of sales. EUR 130 million of this amount related to an increase in the carrying value of our inventories and EUR 25 million related to increased depreciation of tangible fixed assets.

### Selling expenses

Selling expenses, as a percentage of total sales, for the combined period of 2006, were 7.3% compared to 6.4% in 2005. The higher selling expenses in 2006 were mainly the result of spending on customer design-in efforts. In addition, 2006 expenses included restructuring charges for the relocation of the back office and several of our sales offices, which we have undertaken in order to better service our customers.

### General and administrative expenses

The General and administrative expenses (G&A), excluding the purchase accounting effect, amounted to EUR 380 million (7.7% of total sales) for the combined periods in 2006, compared to EUR 435 million (9.1% of total sales) for the full year 2005. This reduction reflects the positive effects from our Business Renewal Program.

Total G&A expenses include EUR 62 million for corporate functions and regional overhead, historically provided or incurred by Philips, for the period January 1, 2006 through September 28, 2006 compared to EUR 81 million for the full year 2005. As a stand-alone organization, EUR 4 million in costs were recorded for the period September 29, 2006 through December 31, 2006.

Purchase accounting effects included for the period September 29, 2006 through December 31, 2006 amounted to EUR 120 million and were related to amortization of intangible assets.

### Research and development expenses

The research and development expenses, excluding purchase accounting effects, amounted to EUR 995 million (20.1% as a percentage of total sales) for 2006, compared to EUR 1,028 million for the full year 2005 (21.6% as a percentage of total sales). Our portfolio management and the corresponding exit of some of our product lines (including DVD-R and mobile display drivers) freed up research and development resources which were redirected to our key battle areas, especially 3G cellular systems and in-car entertainment.

Total research and development expenses include EUR 13 million for research activities, historically provided or incurred by Philips, for the period January 1, 2006 through September 28, 2006 compared to EUR 14 million for the full year 2005. As a stand-alone organization, costs of EUR 10 million were recorded for the period September 29, 2006 through December 31, 2006. Purchase accounting effects amounted to EUR 515 million for the period September 29, 2006 through December 31, 2006 and were related to write-off of acquired in-process research and development.

## Other income

Other business income was EUR 21 million for 2006, mainly related to the sale of property as well as release of litigation provisions. For 2005 the amount was EUR 36 million, reflecting the gain from the disposal of certain fixed assets and amounts received from a settlement of a legal dispute with a supplier.

## Earnings before interest and taxes

EBIT was EUR 150 million in 2006, excluding the purchase accounting effect of EUR 790 million, compared to EUR 102 million in 2005.
2006 EBIT includes cost allocations from Philips of EUR 82 million and stand alone costs of EUR 27 million. For 2005, EUR 94 million of cost allocations were recorded.

## Adjusted EBITDA

For 2006, Adjusted EBITDA was EUR 921 million, compared to EUR 1,030 million in the same period last year. This decrease of EUR 109 million was mainly related to negative currency effects (EUR 35 million) and additional development investments (EUR 85 million) in our Automotive & Identification and Mobile & Personal businesses.

The adjustments made to 2006 EBITDA to arrive at Adjusted EBITDA consist of:

- minority interest and results of unconsolidated companies of EUR 53 million
- restructuring costs of EUR 21 million, litigation costs of EUR 30 million and legal disentanglement costs of EUR 30 million
- exit of product lines of EUR 44 million and
- other items of EUR 24 million.

EBITDA adjustments in 2005 totaled EUR 149 million, consisting of exit of product lines (EUR 110 million) and results of unconsolidated companies and minority interests (EUR 39 million).

The following table represents the net income elements for the years ended December 31, 2005 and 2006:

### Net income (loss)

| In millions of euros | Predecessor | | Successor | Combined | | |
|---|---|---|---|---|---|---|
| | For the year ended December 31, 2005 | For the period January 1, 2006 – September 28, 2006 | **For the period September 29, 2006 – December 31, 2006** | For the year ended December 31, 2006 | Effects of PPA | **December 31, 2006 (As adjusted to eliminate PPA effects)** |
| Earnings before interest and tax | 102 | 139 | **(779)** | (640) | (790) | **150** |
| Financial income and (expenses) | (63) | (22) | **(73)** | (95) | - | **(95)** |
| Income tax benefit (expense) | (101) | (65) | **242** | 177 | 227 | **(50)** |
| Results unconsolidated companies | (5) | 3 | **(2)** | 1 | - | **1** |
| Minority interests | (34) | (50) | **(4)** | (54) | - | **(54)** |
| Net income/(loss) | (101) | 5 | **(616)** | (611) | (563) | **(48)** |

### Financial income and expenses

Financial expenses amounted to EUR 95 million for 2006 consisting of net interest expenses of EUR 98 million, financing costs of EUR 45 million, and the positive effect of exchange rates of our USD-denominated notes, which amounted to EUR 48 million.
Financial expense in 2005 amounted to EUR 63 million, mainly related to net interest expenses as incurred on funding by Philips.

### Income tax benefit (expenses)

The income tax benefit was EUR 242 million for the period September 29, 2006 through December 31, 2006, largely related to the EUR 227 million purchase accounting effect.
For the period January 1, 2006 through September 28, 2006 income tax amounted to EUR 65 million.
In 2005 income tax was EUR 101 million; this includes EUR 38 million for withholding taxes.

### Results relating to unconsolidated companies

Results relating to unconsolidated entities showed a profit of EUR 1 million for the combined period of 2006 as compared to a loss of EUR 5 million for 2005. These results relate to our participations in Advanced Semiconductor Manufacturing Company and T3G.

### Minority interests

The share of minority interests of EUR 54 million relates to our joint ventures Systems on Silicon Manufacturing Company (SSMC) (EUR 52 million) and Jilin (EUR 2 million). The minority interest in 2005 was EUR 34 million and was mainly related to SSMC. In November 2006 we increased our shareholding in SSMC by 10.7% to 61.2%.

## Performance by segment 2006 compared to 2005

The following tables present total sales and EBIT by segment for the combined period of January 1, 2006 through September 28, 2006 and September 29, 2006 through December 31, 2006, together with the full year 2005:

### Total sales

| | Predecessor | | Combined | |
|---|---|---|---|---|
| in millions of euros | For the year ended December 31, 2005 | % nominal growth | For the year ended December 31, 2006 | % nominal growth |
| Mobile & Personal | 1,618 | 6.1 | 1,568 | (3.1) |
| Home | 1,002 | (5.5) | 942 | (5.9) |
| Automotive & Identification | 719 | 1.8 | 872 | 21.4 |
| MultiMarket Semiconductors | 1,238 | (2.4) | 1,345 | 8.6 |
| IC Manufacturing Operations | 146 | - | 168 | - |
| Corporate and Other | 43 | - | 65 | - |
| | 4,766 | (1.2) | 4,960 | 4.1 |

## EBIT

| in millions of euros | Predecessor: For the year ended December 31, 2005 | Predecessor: As a % of sales | Combined: For the year ended December 31, 2006 | Combined: For the year ended December 31, 2006 (As adjusted to eliminate PPA effects) | As a % of sales |
|---|---|---|---|---|---|
| Mobile & Personal | 72 | 4.4 | (112) | **42** | **2.7** |
| Home | (85) | (8.5) | (201) | **(55)** | **(5.9)** |
| Automotive & Identification | 168 | 23.4 | (105) | **194** | **22.3** |
| MultiMarket Semiconductors | 139 | 11.2 | 124 | **272** | **20.2** |
| IC Manufacturing Operations | 32 | - | (64) | **(22)** | **-** |
| Corporate and Other | (224) | - | (282) | **(281)** | **-** |
| | 102 | 2.1 | (640) | **150** | **3.0** |

## Mobile & Personal

### *Total sales*

Total sales in 2006 were EUR 1,568 million compared to EUR 1,618 million in 2005, a nominal decrease of 3.1%. On a comparable basis total sales 2006 decreased by 2.0%. Sales in our Connectivity business line grew 6% in 2006, as a result of strong growth in bluetooth and embedded connectivity devices. Growth in Personal Entertainment Solutions of 6% was primarily driven by Nexperia multimedia sales. Sales in our Cellular business line slowed down in the last three months of 2006 due to weaker market conditions. Sales in our business line Cordless & IP terminals suffered from strong price erosion, caused by the commoditization of these products. In addition, our customers are increasingly demanding “naked dies” or unpackaged semiconductors, in the cordless market segment, which attract lower prices. Sales in our Sound Solutions business increased in 2006 by 5%.

### *Earnings before interest and taxes*

EBIT in 2006 was a loss of EUR 112 million, compared to a profit of EUR 72 million in 2005. Excluding the effect from purchase accounting the EBIT 2006 was a profit of EUR 42 million. The decrease compared to 2005 was mainly due to increased research and development investments in key growth areas, including 3G cellular systems and Nexperia multimedia solutions and a significant price erosion in FM radio products. The higher R&D costs and lower margins were partially off set by lower G&A costs as a result of efficiency improvements.

## Home

### *Total sales*

Total sales in 2006 were EUR 942 million compared to EUR 1,002 million in 2005, a nominal decrease of 5.9%. On a comparable basis, total sales 2006 decreased by 4.9%. Sales in the last three months of the year were weak as a consequence of inventory corrections at our customers. The fourth quarter showed a further decline in the CRT TV related sales, reflecting the current market transition to digital. In the analog market segment, NXP holds a market share of above 40%. Lower sales in PC Systems and more particular in our personal computer systems business, was caused by delays in the development of the PC TV market and later than expected available solutions for this market.

*Earnings before interest and taxes*

EBIT in 2006 amounted to EUR 201 million compared to a loss of EUR 85 million in 2005. Excluding the effect from purchase accounting, the loss in 2006 was EUR 55 million. The 2006 results benefited from higher contributions from digital television, set-top box and tuner businesses. Reductions in research and development spending in these areas also contributed to these improvements. Furthermore the exit from the DVD-R business reduced our cost base.

## Automotive & Identification

*Total sales*

Total sales in 2006 were EUR 872 million compared to EUR 719 million in 2005, a nominal increase of 21.4%. On a comparable basis total sales increased by 22.2% in 2006. The increase mainly derived from our identification businesses in eGovernment and automatic fare collection products. This growth was strongly driven by recent design wins for our electronic passport products. Further our Radio Frequency Identification sales, which include our automatic fare collection products, were up strongly. In automatic fare collection, our MiFare products have become an industry standard and growth was driven by the continuing adoption of our products in this market. Our automotive sales increased slightly above overall growth in the automotive market.

*Earnings before interest and taxes*

EBIT in 2006 was a loss of EUR 105 million, compared with a profit of EUR 168 million in 2005. Excluding the effects of purchase accounting, 2006 EBIT was a profit of EUR 194 million. The increase in 2006 was highly driven by higher sales. Due to the attractiveness of the markets it supplies, we increased our research and development efforts in this business unit during the course of 2006.

## MultiMarket Semiconductors

*Total sales*

Total sales in 2006 were EUR 1,345 million, compared to EUR 1,238 million in 2005, an increase of 8.6% in nominal terms. Excluding currency effects, total sales increased by 9.6% as a result from significantly higher sales in our Standard ICs, General Application and Power Management business lines. Sales in Standard ICs increased substantially, driven by strong growth in general purpose logic, interface products and microcontrollers. General Application sales increase was primarily related to a strong gain in overall market share, coupled with strong market demand for transistors & diodes, and a ramp-up of earlier design wins in integrated discretes. Power Management sales went up moderately, driven by strong growth in power solutions and data-converters.
These increases were partially offset by the phasing out of our Mobile Display Drivers product line.

*Earnings before interest and taxes*

EBIT in 2006 was EUR 124 million, compared to EUR 139 million in 2005. Excluding the effect of purchase accounting, 2006 EBIT was EUR 272 million. This increase over 2005 resulted from higher sales volumes and margins, the latter resulting from stable market prices and higher utilization rates at our discrete semiconductor manufacturing facilities. Our continuing rationalization of manufacturing operations and in particular our shift of bipolar power discrete semiconductor fabrication activities from the United Kingdom to China, has resulted in significant cost savings.

## IC Manufacturing Operations

*Total sales*

Total sales in 2006 were EUR 168 million compared to EUR 146 million in 2005, a nominal increase of 15%. The sales growth was related to higher sales by SSMC to TSMC.

*Earnings before interest and taxes*
EBIT in 2006 was a loss of EUR 64 million, compared to a profit of EUR 32 million in 2005. Excluding the effect of purchase accounting, 2006 EBIT was a loss of EUR 22 million. Substantial erosion in wafer prices and higher spending in the Crolles Alliance affected negatively the EBIT in 2006. This was partly offset by lower depreciation and amortization cost resulting from the continued implementation of our asset-light strategy, and savings from our Business Renewal Program.

### Corporate and Other

*Total sales*
Total sales in 2006 were EUR 65 million compared to EUR 43 million in 2005, and related to IP licensing income and software.

*Earnings before interest and taxes*
EBIT was a loss of EUR 224 million in 2005 compared to a loss of EUR 282 million in 2006 and are related to cost allocations from Philips, restructuring charges, pension costs, IP management cost, and costs for corporate research and development and corporate infrastructure.

## NXP Semiconductors Group performance 2005 compared to 2004

The combined financial statements for the full year 2005 are for periods ended prior to our acquisition, and represent the financial results and position of the semiconductors businesses of Philips that were transferred to us in connection with our acquisition by KASLION.

The following table presents earnings before interest and tax (EBIT) for the years ended December 31, 2005 and 2004:

EBIT

| | Predecessor | | Predecessor | |
|---|---|---|---|---|
| | 2004 | | 2005 | |
| In millions of euros | | % of sales | | % of sales |
| Total sales | 4,823 | | 4,766 | |
| % nominal growth | 13.3 | | (1.2) | |
| % comparable growth | 19.5 | | (1.4) | |
| Gross Margin | 1,868 | 38.7 | 1,833 | 38.5 |
| Selling Expenses | (297) | (6.2) | (304) | (6.4) |
| General & Administrative expenses | (437) | (9.1) | (435) | (9.1) |
| Research & Development expenses | (979) | (20.3) | (1,028) | (21.6) |
| Other business income (expense) | 79 | 1.6 | 36 | 0.7 |
| Earnings before interest and tax (EBIT) | 234 | 4.9 | 102 | 2.1 |

*Total sales*

Total sales were EUR 4,766 million for 2005, compared to EUR 4,823 million for 2004, a decrease of 1.2%. This reflects the effects of a significant decrease in total sales to Philips, primarily attributable to our exit of the mobile display drivers and DVD-R businesses, while total sales to non-Philips customers remained essentially flat. Increased sales in Mobile & Personal and Automotive and Identification were offset by decreases in Home and MultiMarket Semiconductors. Overall, total sales were weaker in the first half of 2005, reflecting generally slow demand growth in the semiconductor industry. The market improved significantly in the second half of the year, particularly in the fourth quarter. Excluding foreign currency effects, total sales in 2005 decreased 1.4% over 2004.

*Gross Margin*

Gross margin was EUR 1,833 million, representing 38.5% of total sales, in 2005, compared to EUR 1,868 million, representing 38.7% of total sales, in 2004. This decrease was caused primarily by sales of lower-margin products and lower utilization levels during the first half of 2005. Throughout 2005, we improved manufacturing efficiencies, increased yields and generally reduced operating costs. This, coupled with improving sales volumes and the resulting utilization increase in the second half of the year, led to significantly improved gross margin results during the third and fourth quarters.

*Selling expenses*

Selling expenses remained at similar levels, with selling expenses of EUR 304 million, representing 6.4% of total sales, for 2005, compared to EUR 297 million, representing 6.2% of total sales, for 2004.

*General and administrative expenses*

General and administrative expenses were EUR 435 million for 2005, representing 9.1% of total sales, compared to EUR 437 million, representing 9.1% of total sales, for 2004. We undertook a significant management reorganization, designed to reduce general and administrative expenses, in the second half of 2005. There was no significant impact, however, on our 2005 expense levels. To the extent that marginal savings were recognized in the second half of 2005, they were generally offset by one-time costs associated with initiating the reorganization.

*Research and development expenses*

Research and development expenses were EUR 1,028 million for 2005, compared to EUR 979 million for 2004, an increase of 5.0%. This increase was related to higher research and development expenditures incurred in connection with, amongst other research priorities, the introduction of digital television and 3G cellular systems products, respectively, during 2005. We incurred a EUR 6 million charge during 2005 relating to the rationalization of our research and development sites and a slight reduction in headcount.

*Other business income*

Other business income was EUR 36 million for 2005, compared to EUR 79 million for 2004, a decrease of 54.4%. The decrease was due principally to the extraordinary receipt in 2004 of insurance proceeds related to fires at certain of our facilities, in the amount of EUR 63 million. The 2005 figure is comprised of EUR 17 million in gain from the disposal of certain fixed assets, primarily at former sites in San Jose, California and Vienna, Austria, and EUR 19 million in other revenues, most significantly amounts received from settlement of a legal dispute with a supplier. The 2004 figure, other than the insurance proceeds, consisted of EUR 12 million in gain from the disposal of fixed assets, primarily real property in San Jose, California.

***Earnings before interest and taxes***

EBIT was EUR 102 million, representing 2.1% of total sales, in 2005, compared to EUR 234 million, representing 4.9% of total sales, in 2004, a decrease of 56.4%. This decrease principally resulted from the reduction in other business income arising from the absence of the extraordinary receipt of insurance proceeds in 2004, lower sales, and higher research and development costs.

The following overview represents the composition of net income for the years ended December 31, 2005 and 2004:

Net income (loss)

| | Predecessor 2004 | | Predecessor 2005 | |
|---|---|---|---|---|
| In millions of euros | | % of sales | | % of sales |
| Earnings before interest and tax | 234 | 4.9 | 102 | 2.1 |
| Financial income (expenses) | (93) | (1.9) | (63) | (1.3) |
| Income tax benefit (expense) | (113) | (2.3) | (101) | (2.1) |
| Results unconsolidated companies | 12 | 0.2 | (5) | (0.1) |
| Minority interests | (26) | (0.5) | (34) | (0.7) |
| Net income (loss) | 14 | 0.3 | (101) | (2.1) |
| EBITDA | 1,069 | | 881 | |

***Financial expense***

Financial expense was EUR 63 million for 2005, compared to EUR 93 million for 2004, a decrease of 32.3%. This decrease resulted principally from lower interest expenses, which in turn resulted from lower allocated debt levels from Philips. Excluding the allocated portion of Philips interest expense, interest expense was EUR 19 million in 2005, compared to EUR 22 million in 2004.

***Income tax expense***

Income tax expense was EUR 101 million for 2005, compared to EUR 113 million for 2004. These figures include withholding taxes of EUR 17 million and EUR 38 million in 2004 and 2005, respectively.

***Results relating to unconsolidated entities***

Results relating to unconsolidated entities amounted to a loss of EUR 5 million for 2005, compared with a gain of EUR 12 million for 2004. The 2005 loss was comprised mainly of losses resulting from our shareholdings in ASMC. The gain in 2004 relates to results at ASMC and a gain we realized on the sale of shares of a small strategic investment.

***Minority interests***

Minority interests were EUR 34 million for 2005, compared to EUR 26 million for 2004, an increase of 30.8%. For both 2005 and 2004, these minority interests related almost exclusively to minority shareholdings in SSMC.

***Net income (loss)***

Net loss was EUR 101 million for 2005, compared to net income of EUR 14 million for 2004. This difference is due principally to the absence of the extraordinary insurance receipt that was received in 2004, together with 2005 results that were adversely affected by lower sales, higher research and development costs.

## Performance by segment for 2005 compared to 2004

The following tables represent total sales and EBIT for 2005 for the years ended December 31, 2005 and 2004:

### Sales growth

| | Predecessor 2005 | | |
|---|---|---|---|
| In millions of euros | Sales | % nominal growth | % comparable growth |
| Mobile & Personal | 1,618 | 6.1 | 5.8 |
| Home | 1,002 | (5.5) | (5.9) |
| Automotive & Identification | 719 | 1.8 | 1.9 |
| MultiMarket Semiconductors | 1,238 | (2.4) | (2.5) |
| IC Manufacturing Operations | 146 | (18.0) | - |
| Corporate and Other | 43 | (50.0) | - |
| | 4,766 | (1.2) | (1.4) |

### Sales and EBIT

| | Predecessor 2005 | | |
|---|---|---|---|
| In millions of euros | Sales | EBIT | as a % of sales |
| Mobile & Personal | 1,618 | 72 | 4.4 |
| Home | 1,002 | (85) | (8.5) |
| Automotive & Identification | 719 | 168 | 23.4 |
| MultiMarket Semiconductors | 1,238 | 139 | 11.2 |
| IC Manufacturing Operations | 146 | 32 | - |
| Corporate and Other | 43 | (224) | - |
| | 4,766 | 102 | 2.1 |

### Sales and EBIT

| | Predecessor 2004 | | |
|---|---|---|---|
| In millions of euros | Sales | EBIT | as a % of sales |
| Mobile & Personal | 1,525 | 90 | 5.9 |
| Home | 1,060 | (30) | (2.8) |
| Automotive & Identification | 706 | 159 | 22.5 |
| MultiMarket Semiconductors | 1,268 | 139 | 11.0 |
| IC Manufacturing Operations | 178 | (19) | - |
| Corporate and Other | 86 | (105) | - |
| | 4,823 | 234 | 4.9 |

## Mobile & Personal

*Total sales*

Total sales of our Mobile & Personal segment were EUR 1,618 million for 2005, compared to EUR 1,525 million for 2004, an increase of 6.1%. The increase is primarily attributable to sales growth in Cellular Systems, which showed strong growth in 2005, despite a decline in selling prices due to volume discounts. This sales growth was primarily driven by end-market demand for MP3 players which use our power management products, and 3G cellular handsets that incorporate our radio frequency devices. Growth in Mobile & Personal was also driven by increasing sales in our Personal Entertainment Solutions business line, primarily resulting from our success with FM radios for mobile applications. The effect of these increases were partially offset by a significant decrease in sales of semiconductors for cordless phones, a result of significant price erosion and a declining market share. Also offsetting increases was the effect of our exit from imaging sensor sales, which resulted in a sales reduction of EUR 30 million. Sales in the Sound Solutions business line also decreased as a result of lower sales to a particular customer, who moved in 2004 from a single supplier to a multi-source supplier base. Excluding foreign currency effects, sales of our Mobile & Personal segment increased 5.8% in 2005 over 2004.

*Earnings before interest and taxes*

EBIT of our Mobile & Personal segment was EUR 72 million for 2005, compared to EUR 90 million for 2004, a decrease of 20.0%. This decrease was due mainly to lower margins, which in turn resulted primarily from price decreases in our Cellular Systems business line. These price decreases were the result of pre-negotiated volume-related discounts to certain of our OEM customers. Lower sales of embedded connectivity devices and delayed introduction of a low-cost Bluetooth product also contributed to the decline. We experienced in 2005 an increase in margins in Cordless and IP Terminals following 2004 levels that were negatively impacted by restructuring costs associated with our exit from the camera sensors business. Margins in Personal Entertainment Solutions improved slightly in 2005, due to a favorable market for FM radio and improvements in costs. Increased research and development expenses, which resulted from additional expenditures on 3G cellular systems products and Nexperia multimedia, together with higher sales and marketing costs, also impacted 2005.

## Home

*Total sales*

Total sales of our Home segment were EUR 1,002 million for 2005, compared to EUR 1,060 million for 2004, a decrease of 5.5%. In 2005, our sales to the analog television market, which represents the largest business line in our Home segment, declined substantially compared to 2004. Although overall sales decreased, our market share increased. The effects of the decrease in analog television sales were partially offset by an increase in sales to the digital television market, which is, in large part, replacing the analog television market. Our market share in digital television, while trending upwards, remained significantly lower than for analog television, and as a result digital television sales did not make up for the decline we experienced in the analog market. Our sales into the digital television market more than doubled in 2005, but in absolute terms the amount of sales remained small. Increases were also seen in television front-end and radio frequency solutions, which in turn related to a strong set-top boxes market generally. Our front-end and radio frequency products are used in a large number of set-top boxes not incorporating our set-top boxes system solution. Excluding foreign currency effects, total sales in Home decreased 5.9% in 2005 as compared to 2004.

*Earnings before interest and taxes*

The EBIT of our Home segment was a loss of EUR 85 million in 2005, compared to an EBIT loss of EUR 30 million for 2004. This increase resulted principally from the impact of lower gross margins. The lower gross margins were in turn caused primarily by price pressures in the television market. Consumer prices for analog televisions decreased substantially and, while we were able to lower our costs, we nevertheless experienced a small decline in our gross margin. Given the large size of the business line, this small decline had a significant impact on our overall gross profit. In digital television, gross margins also declined substantially in large part due to strong competition for market share, and also due to relatively high costs associated with early-stage production. A significant decrease was also seen in television tuners, as a result of pricing pressures. DVD-R margins also suffered, and as a result we decided to exit this business, effective January 1, 2006. Other cost reduction measures, such as the closing of two development sites, were taken in 2005, but the associated cost savings did not impact our results in that year.

## Automotive & Identification

*Total sales*

Total sales of our Automotive & Identification segment for 2005 were EUR 719 million, compared to EUR 706 million for 2004, an increase of 1.8%. Excluding the effects of an extraordinary non-recurring sale of smartcard devices in 2004, which resulted from supply problems at a competitor, total sales increased by EUR 77 million, or 12%. This increase was due to generally higher sales across each of our Automotive & Identification business lines, with the exception of Car Entertainment Solutions, where delays in new product launches adversely impacted sales. Automotive sales were up, in part due to market share gains in Car Access and Immobilizer Systems. Overall our Identification businesses grew slightly below the broader industry. Several businesses, however, showed particularly strong growth, especially RFID, which increased sales as a result of sales for supply chain management and animal identification applications. Excluding foreign currency effects, total sales in Automotive & Identification increased 1.9% in 2005 as compared to 2004.

*Earnings before interest and taxes*

EBIT of our Automotive & Identification segment was EUR 168 million in 2005, compared with EUR 159 million in 2004, an increase of 5.7%.

This increase is due principally to improvements in gross margin, which improved broadly across all of our identification businesses, in large part due to a beneficial product mix effect, as well as through continued growth in high-margin areas of the SIM market, such as high-security bank cards and embedded memory devices. These positive effects were partially offset by increased research and development expenses, which primarily related to expenditures in our Car Entertainment Solutions business line.

## MultiMarket Semiconductors

*Total sales*

Total sales of our MultiMarket Semiconductors segment were EUR 1,238 million for 2005, compared to EUR 1,268 million for 2004, a decrease of 2.4%. Our exit from the Mobile Display Drivers business line, which we commenced in the second half of 2005, was a major contributor to the decline. Excluding the effect of the Mobile Display Drivers exit, sales were essentially flat. General market weakness in the first half of 2005 led to moderate declines in radio frequency products.

Sales in our Power Management business line also declined, mainly due to our decision to reduce our sales efforts in this business line in advance of the restructuring of our bipolar power operations. Bipolar Power sales declined significantly compared to the prior period. Sales in our Standard ICs business line remained flat, mainly due to gains in market share in General Purpose Logic in the second half of the year, which offset a decline in sales of Interface Products and Microcontrollers. Excluding foreign currency effects, total sales in MultiMarket Semiconductors decreased 2.5% in 2005 as compared to 2004.

*Earnings before interest and taxes*

EBIT of our MultiMarket Semiconductors segment was EUR 139 million for 2005, compared to EUR 139 million for 2004. Gross margins improved in certain business lines, such as General Application and Standard ICs, primarily due to volume effects and gains in market share. These gains were offset, however, by a reduction in gross margins in our Mobile Display Drivers and Power Management business lines, which resulted from significantly lower volumes in each of these businesses. Price erosion in mobile display drivers, a result of the increasing commoditization of these products, also contributed to the margin reduction. Other expenses in 2005, such as selling and research and development costs, were essentially flat with 2004 levels. Restructuring costs of EUR 8 million and EUR 4 million were recorded in 2005 and 2004, respectively.

## IC Manufacturing Operations

*Total sales*

Total sales of our IC Manufacturing Operations segment were EUR 146 million for 2005, compared with EUR 178 million for 2004, a decrease of 18.0%. This decrease resulted primarily from a discontinuation of external sales of semiconductors for projection televisions from our plant in Böblingen, Germany. Excluding foreign currency effects, total sales in IC Manufacturing Operations decreased 18.0% in 2005 over 2004.

*Earnings before interest and taxes*

EBIT of our IC Manufacturing Operations segment was EUR 32 million for 2005, compared with an EBIT loss of EUR 19 million for 2004. This improvement resulted principally from a reduction in production costs, which in turn related to the implementation of our Business Renewal Program, and from lower depreciation expenses resulting from the full depreciation of several of our manufacturing assets, decreased capital spending and the continued implementation of our asset-light manufacturing strategy.

## Corporate and Other

*Total sales*

Total sales of our Corporate and Other segment in 2005 were EUR 43 million, compared to EUR 86 million in 2004, a decrease of 50.0%. This decrease principally reflects a decline in IP license income.

*Earnings before interest and taxes*

EBIT of our Corporate and Other segment in 2005 was a loss of EUR 224 million, compared to a loss of EUR 105 million in 2004, an increase of 113.3%. In each of 2004 and 2005, losses related primarily to certain cost allocations, including restructuring charges and certain cost allocations relating to items including pensions, IP management, corporate research and development and corporate infrastructure.

# Employment

## Employees by sector

| In number of FTE | As of December 31, 2005 | As of September 28, 2006 | **As of December 31, 2006** |
|---|---|---|---|
| Mobile & Personal | 2,992 | 3,216 | **3,473** |
| MultiMarket Semiconductors | 5,737 | 6,901 | **6,804** |
| Home | 4,346 | 3,759 | **3,546** |
| Automotive & Identification | 768 | 1,002 | **1,095** |
| IC Manufacturing Operations | 17,458 | 17,930 | **17,442** |
| Corporate and Other | 4,336 | 5,336 | **5,108** |
| | 35,637 | 38,144 | **37,468** |

## Employees by geographic area

| In number of FTE | As of December 31, 2005 | As of September 28, 2006 | **As of December 31, 2006** |
|---|---|---|---|
| Europe and Africa | 12,865 | 13,604 | **13,698** |
| Americas | 1,801 | 1,820 | **1,827** |
| Greater China | 6,790 | 7,944 | **7,739** |
| Asia Pacific | 14,181 | 14,776 | **14,204** |
| | 35,637 | 38,144 | **37,468** |

Upon our Separation as a stand-alone company approximately 900 employees, primarily in the areas of research and development (around 40%), applied technologies (around 20%), intellectual property management, IC manufacturing organization (around 10%) and other corporate functions (around 30%), were transferred from Philips to NXP. These additions were made to enable us to no longer rely on Philips to provide central corporate services to us, except for certain limited areas where we have entered into temporary transitional services agreements with Philips. Furthermore, de-bottlenecking of our back-end activities has lead to an increased number of employees in Greater China principally in our MultiMarket Semiconductors and IC Manufacturing Operations business units. Our Home business unit decreased its number of employees mainly due to reduction of the number of contractors and restructuring activities. In our Corporate and Other segment figures for 2006 include personnel for NXP Software (around 200 employees).

# Liquidity and capital resources

The Company principally generates cash through its operating activities. In 2006, in connection with the Acquisition, the Company issued EUR 4,529 million (euro-equivalent) aggregate principal amount of fixed- and floating rate notes and entered into an EUR 500 million secured revolving credit facility. EUR 734 million of the gross proceeds from a bridge loan was retained by the Company as cash, with the balance used to refinance debt incurred in connection with the Acquisition. As a result of these activities, the Company must use a substantial amount of any cash it generates to service its debt.

## Cash flows

The condensed combined and consolidated statements of cash flows are presented as follows:

### Condensed cash flow statements

| In millions of euros | PREDECESSOR For the years ended December 31, 2004 | PREDECESSOR For the years ended December 31, 2005 | PREDECESSOR For the period January 1, 2006 – September 28, 2006 | SUCCESSOR For the period September 29, 2006 – December 31, 2006 |
|---|---|---|---|---|
| Cash flow from operating activities: | | | | |
| Net income (loss) | 14 | (101) | 5 | (616) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities | 964 | 893 | 463 | 908 |
| Net cash provided by operating activities | 978 | 792 | 468 | 292 |
| Net cash used for investing activities | (590) | (358) | (457) | (184) |
| Net cash (used for) provided by financing activities | (448) | (408) | 48 | 702 |
| Cash (used for) provided by operations | (60) | 26 | 59 | 810 |
| Effect of changes in consolidations on cash positions | 117 | - | - | - |
| Effect of changes in exchange rates on cash positions | (6) | 9 | (10) | (30) |
| Cash and cash equivalents at beginning of period | 24 | 75 | 110 | 159 |
| Cash and cash equivalents at end of period | 75 | 110 | 159 | 939 |

## Cash flow from operating activities

The Company's net cash provided by operating activities for the period September 29, 2006 through December 31, 2006 was EUR 292 million. Cash flows for this period were primarily influenced by operations and positive changes in working capital.

## Cash flow from investing activities

The Company's net cash used for investing activities for the period September 29, 2006 through December 31, 2006 was EUR 184 million. It included the purchase of an additional stake of 10.7% in SSMC at the cost of USD 113 million (EUR 90 million), and capital expenditures of EUR 111 million. The remaining amount is mostly related to disposal proceeds of property, plant and equipment.

## Cash flow from financing activities

The Company's net cash provided by financing activities for the period September 29, 2006 through December 31, 2006 was EUR 702 million, consisting of the following major items: gross proceeds from a bridge loan of EUR 4,500 million; repayment of a loan from Philips, net of settlements, of EUR 3,704 million; gross proceeds from the issuance of notes in October 2006 of EUR 4,529 million; the subsequent equivalent of EUR 4,528 million repayment of the bridge loan.

## Financing

The condensed combined and consolidated balance sheet at December 31, 2005 and 2006 are presented as follows:

### Condensed balance sheet

| | PREDECESSOR | SUCCESSOR |
|---|---|---|
| In millions of euros | 2005 | 2006 |
| Cash and cash equivalents | 110 | **939** |
| Receivables and other assets | 817 | **845** |
| Inventories | 696 | **646** |
| Investment in unconsolidated companies | 48 | **44** |
| Other non-current financial assets | 7 | **12** |
| Property plant and equipment – net | 2,056 | **2,284** |
| Goodwill and intangible assets - net | 271 | **5,097** |
| Total assets | 4,005 | **9,867** |
| Accounts payable, accruals and other liabilities | 1,082 | **1,149** |
| Provisions | 141 | **422** |
| Debt (including loans from Philips) | 1,483 | **4,449** |
| Minority interests | 173 | **162** |
| Business' and Shareholder's equity | 1,126 | **3,685** |
| Total liabilities and business' and shareholder's equity | 4,005 | **9,867** |

## Cash and cash equivalents

Prior to September 29, 2006 we financed our operations principally through Philips and its centralized cash management system.

The acquisition of additional shares of SSMC in November 2006, which was paid for out of available cash, reduced our cash position by EUR 90 million.
Currency changes during the last three months of 2006 had a negative effect of EUR 30 million on our year-end 2006 cash position.
As of December 31, 2006 we had a combined and consolidated cash position of EUR 939 million (as of September 28, 2006: EUR 159 million; 2005: EUR 110 million; 2004: EUR 75 million).

## Debt position

In October 2006 we issued an aggregate euro-equivalent principal amount of EUR 4,529 million in fixed- and floating rate notes, in the following series:

- EUR 1,000 million floating rate senior secured notes due 2013
- USD 1,535 million floating rate senior secured notes due 2013
- USD 1,026 million 7 7/8% senior secured notes due 2014
- EUR 525 million 8 5/8% senior notes due 2015
- USD 1,250 million 9 ½% senior notes due 2015

Currency effects after the date of issuance related to these notes led to a reduction of EUR 111 million in our debt position. As of December 31, 2006 we had long-term debt of EUR 4,426 million and short-term debt of EUR 23 million.

## Net debt

As of December 31, 2006 the Company had a net debt position (total debt minus cash and cash equivalents) of EUR 3,510 million.
Our net debt to group equity ratio was 48 : 52 as of December 31, 2006.

## Shareholder's equity

As a result of the Separation from Philips we started as a stand-alone company with shareholder's equity of EUR 4,305 million at September 29, 2006. During the period September 29, 2006 through December 31, 2006 major changes in equity related to our net loss for that period of EUR 616 million, translation differences that resulted in a decrease of EUR 10 million and other comprehensive income of EUR 6 million.
As of December 31, 2006, we had shareholder's equity of EUR 3,685 million.

## Liquidity position

Management expects our cash on hand, cash flows from operations and funds available under our senior secured revolving credit facility to provide sufficient liquidity to fund our current obligations, expected working capital requirements, restructuring obligations and capital spending for a period that includes the next 12 months. We had EUR 500 million available under a senior secured revolving credit facility that was arranged at September 29, 2006. As of December 31, 2006, our cash and cash equivalents were EUR 939 million and we had used approximately EUR 2 million of our revolving credit facility for the issuance of guarantees, with approximately EUR 498 million in available credit still remaining. The facility expires in 2012.

Prior to the Separation, we financed our operations principally through Philips and its centralized cash management system, whereby we transferred all cash deposits to Philips and withdrew cash from Philips as necessary to fund our business. The balance of these accounts is reflected in business' equity on our combined balance sheet, as Philips' net investment in our company.

Following the Separation, we have implemented our own cash management structure for global cash pooling and centralized cash management. Short-term fluctuations in our cash requirements are generally funded from our cash balances.

Including our cash position and the senior secured revolving credit facility, we had access to liquidity resources of EUR 1,437 million as of December 31, 2006.

# Guarantees and contractual obligations

## Guarantees

All of our guarantees issued or modified after December 31, 2002 having characteristics defined in FASB Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" (FIN45), are measured at fair value and recognized on the balance sheet. At the end of December 31, 2006, the total fair value of such guarantees was nil.
Guarantees issued before December 31, 2002 and not modified afterwards, and guarantees issued after December 31, 2002, which do not have characteristics defined in FIN45, remain off-balance sheet.
As of December 31, 2006 there were no such guarantees recognized.

## Contractual obligations

Presented below is a summary of the NXP Semiconductors Group's contractual obligations provided, as per December 31, 2006, in millions of euros:

| | Total | Less then 1 year | 1 – 3 years | 3 – 5 years | after 5 years |
|---|---|---|---|---|---|
| Long-term debt | 4,420 | - | 2 | - | 4,418 |
| Capital lease obligations | 8 | 2 | 2 | 2 | 2 |
| Short-term debt | 21 | 21 | - | - | - |
| Operating leases | 89 | 23 | 22 | 14 | 30 |
| Interest on the notes* | 2,817 | 355 | 710 | 710 | 1,042 |
| Total contractual cash obligations | 7,355 | 401 | 736 | 726 | 5,492 |

* on the basis of LIBOR and EURIBOR interest rates and USD/EUR balance sheet rates as per December 31, 2006.

The Company had total amounts payable in relation to accrued interest on debt of EUR 79 million as at December 31, 2006.

NXP has a number of contractual agreements such as supply agreements, with provisions that certain penalties may be charged to the Company if the Company does not fulfill its commitments. Please refer to note 29.

## Restructuring

For the period January 1, 2006 through September 28, 2006 restructuring and impairment charges related to the reduction of the back-offices of the European sales organizations from six to two locations and rationalizing the front-office of these organizations, in order to be in line with the Business Renewal program. For the period September 29, 2006 through December 31, 2006 the net balance of additions and releases was mainly also related to the sales organizations in Europe and as well as discontinuity of our activities in Stadskanaal. In 2005, the charges related to a further reduction of excess capacity; overhead and R&D costs in Europe included the lay-off of 700 workers and 225 workers, respectively.

## Acquisitions and divestments

In 2005 (predecessor period) we acquired additional shares in SSMC (Singapore) resulting in a cash payment of EUR 22 million. Goodwill of EUR 14 million was recognized as a result of this transaction. The shareholding in SSMC increased from 48.0% to 50.5%. As a result of exercising the option to acquire additional shares in SSMC from the Economic Development Board (EDB) in November 2006 (successor period), our participation increased further from 50.2% to 61.2% at cost of EUR 90 million.

# Risk management

The following sections present an overview of NXP's approach to risk management and business control and a description of the nature and the extent of its exposure to risks. NXP recognizes different risk categories, namely Market/Business environment, Strategic, Operational, Financial and Compliance and Financial Reporting risks. These are further described in the section "risk categories" of this Annual Report. The risk overview provided is not exhaustive. Some risks not yet known to NXP or currently believed not to be material could later turn out to have a significant impact on NXP's businesses, revenues, income, assets, liquidity or capital resources.

The risk factors should be considered in connection with the information provided under "forward-looking statements", elsewhere in this Annual Report.

## NXP's approach to risk management and business control

Risk management forms an integral part of business management. NXP's risk and control policy is designed to provide reasonable assurance that objectives are met by integrating management control over daily operations, by ensuring compliance with legal requirements and by safeguarding the integrity of the financial reporting and related disclosures. Our management is responsible for identifying critical business risks and for implementing fit-for-purpose risk responses. Internal controls are managed and controlled by a regular assessment of the installed business controls and, if required, corrective actions.

## Corporate governance

NXP believes that good corporate governance is a critical factor in achieving business success. Good corporate governance derives from, amongst other factors, solid internal controls and high ethical standards throughout every aspect of our business. Risk management is well-embedded in NXP's corporate governance model.

The quality of NXP's systems of business controls and the findings of internal and external audits are reported to and discussed by the Audit Committee of the Supervisory Board. Internal auditors monitor the quality of the business controls through risk-based operational audits, inspections of financial reporting controls and compliance audits. Internal audit committees at corporate and business levels meet on a regular basis to address weaknesses as reported by the auditors or from self-assessments and to take corrective action where necessary. These internal audit committees are also involved in determining the desired company-wide internal audit coverage as approved by the Supervisory Board Audit Committee.

## NXP's Business Control Framework

The NXP's Business Control Framework (BCF), derived from the COSO framework on internal control, sets the standard for risk management and business controls in NXP. The objectives of the BCF are to maintain integrated management control of the Company's operations, to ensure integrity of the financial reporting and business processes, as well as to comply with applicable laws and regulations.

With respect to financial reporting, a structured company-wide assessment and monitoring process is in place to enable the Chief Executive Officer and Chief Financial Officer to review the effectiveness of financial risk management and business controls. Each quarter, entities issue a formal certification statement to confirm the adequacy of the design and effectiveness of disclosure controls and internal controls over financial reporting. As part of the annual report process, management's accountability for business controls is enforced through the formal issuance of a Statement on Business Controls and a Letter of Representation.

## Sarbanes-Oxley Act of 2002

In connection with its anticipated registration of exchange notes, NXP expects to become a SEC registrant during 2007. Following this SEC registration, NXP will become subject to certain provisions of the Sarbanes-Oxley Act of 2002, including, effective as of the filing of its second Annual Report on Form 20-F, management certification and auditor attestation requirements relating to its internal controls over financial reporting. In order to ensure compliance, NXP has adopted a top-down, risk-based approach, for which additional resources are being deployed.

## NXP Business Code of Conduct

The NXP Business Code of Conduct (BCC) explicitly lays out the rules of behavior that NXP, as individuals and as an organization, commits to. The BCC outlines NXP's general commitment to be a responsible social partner and the way in which it promises to interact with its stakeholders: customers, shareholders, employees, suppliers and the market. The BCC puts in black and white NXP's commitment to an economically, socially and ethically sustainable way of working. It covers NXP's policy on diverse array of subjects, including corporate gifts, child labor, sexual harassment and the integrity of the financial reporting.

## Risk categories

Taking risks is an inherent part of entrepreneurial behavior. NXP has a structured risk management process in place that recognizes risks in Market/Business environment, Strategic, Operational, Financial and Compliance and Financial Reporting categories that encourages management to take risks in a controlled manner.

### Market/Business environment risks

The market/business environment risks cover the effect that changes in the market may have on NXP. These risks relate to areas, such as economic and political development, that are likely to affect all market participants in a similar manner.

*The financial performance of the semiconductor market is highly dynamic and cyclical; product and technology innovation occurs rapidly, leading to risks.*

As a result of this cyclicality, the semiconductor industry has in the past experienced significant downturns, often in connection with, or in anticipation of, maturing life cycles of semiconductor products and declines in general economic conditions. These downturns have been characterized by diminishing demand for end-user products, high inventory levels, under-utilization of manufacturing capacity and accelerated erosion of average selling prices.

*The semiconductor industry is highly competitive. If NXP fails to introduce new technologies and products in a timely manner, it could adversely impact its business.*

The semiconductor industry is highly competitive and characterized by constant and rapid technological change, short product lifecycles, significant price erosion and evolving standards. Accordingly, the success of NXP's business depends to a significant extent on its ability to develop new technologies and products that are ultimately successful in the market. NXP needs to participate in, and win competitive bid selection processes to develop products for use in its customers' equipment and products. These selection processes can be lengthy with no guarantee of winning a contract or generating revenue. Failure to win new design projects and delays in developing new products may have an adverse effect on NXP's business.

The semiconductor industry is characterized by aggressive pricing and rapidly declining selling prices, especially at the end of the product lifecycle. If NXP is unable to advance its process technologies or to improve its efficiencies, cost reductions will not be sufficient to keep pace with reductions in market prices for the products NXP sells.

*The demand for NXP products depends to a significant degree on the demand for the end products of NXP's customers into which they are incorporated.*

The vast majority of NXP's revenues is derived from sales to OEM and ODM customers in the consumer electronics, communications and automotive industries. Demand of these customers fluctuates significantly, driven by consumer preferences, the development of new technologies and brand performance. The success of NXP depends on the success of its customers in the market place. Such customers may vary order levels significantly from period to period, request postponements to schedule delivery dates, modify their orders or reduce lead times.

*As NXP's business is global, its operations are exposed to economic and political developments, and environmental laws and regulations in countries across the world that could adversely impact its operating result.*

The business environment is influenced by economic and political uncertainties that continue to affect the global economy and the international capital markets. Economic and political developments could have an adverse effect on NXP's operating results. Besides this, NXP is subject to many environmental, health and safety laws and regulations in each jurisdiction in which it operates. It is also required to obtain environmental permits from governmental authorities for certain of its operations. No assurance can be given, that NXP has been or will be at all times in complete compliance with such laws, regulations and permits. If it violates or fails to comply with these laws, regulations or permits, it could be fined or otherwise sanctioned by regulators.

### Strategic business risks

Within strategic business risks, NXP covers areas that influence its choices towards strategic opportunities and threats.

*NXP relies on strategic partnerships and alliances for research and development. Termination could adversely impact NXP's business.*

NXP has entered into long-term strategic partnerships with other leading industry participants. It also engages in alliances. If any of the partners were to encounter financial difficulties or change their business strategies, they may no longer be able or willing to participate.
This could have an adverse effect on NXP's ability to continue the development of certain advanced products and process technologies.

***NXP relies to a significant extent on proprietary intellectual property. It may not be able to protect this intellectual property against improper use by its competitors or others.***

NXP depends on patents and other intellectual property rights to protect its products against misappropriation by its competitors or others. The patents the Company receives may be insufficient to provide meaningful protection. NXP may not be able to obtain patent protection or secure other intellectual property rights in all the countries in which it operates, and, under the laws of such countries, patents and other intellectual property rights may be unavailable or limited in scope. Any inability on the part of NXP to protect adequately its intellectual property may have an adverse effect on its business.

***Intellectual property that was transferred or licensed to NXP from Philips may not be sufficient to protect NXP's position in the industry.***

In connection with the Separation, Philips has transferred a set of patent families to NXP subject to certain limitations. These limitations give Philips the right to sublicense to third parties in certain circumstances. The strength and value of the intellectual property may be diluted if Philips licenses or otherwise transfers such intellectual property or such rights to third parties, especially if they compete with NXP.

***NXP may lose rights to key intellectual property arrangements as a result of no longer being a business segment of Philips.***

As the semiconductors division of Philips, NXP benefited from some of Philips' intellectual property arrangements, including cross-licensing arrangements with other semiconductor companies and licenses from third parties of technology incorporated in its products and used to operate its business. Now the Separation has been completed, NXP may no longer be a beneficiary under a number of these agreements. As a result, NXP may not have rights to use important intellectual property that it has previously been licensed to use and may therefore be subject to claims that it is infringing intellectual property rights of third parties.

***NXP may become party to intellectual property claims or litigation that could cause NXP to incur substantial costs or pay substantial damages or prohibit NXP from selling its products.***

NXP may receive communications alleging possible infringement of patents and other intellectual property rights of others. Furthermore, NXP may become involved in costly litigation brought against it regarding patents, copyrights, trademarks, trade secrets or other intellectual property rights. If any such claims are asserted against NXP, it may seek to obtain a license under the third party's intellectual property rights. NXP cannot assure that it will be able to obtain any or all of the necessary licenses on satisfactory terms, if at all.

In the event that NXP cannot obtain a license, these parties may file lawsuits seeking damages or an injunction against the sale of its products that incorporate allegedly infringed intellectual property or against the operation of its business as presently conducted. Such lawsuits could result in an increase in the costs of selling certain products, a need to partially or completely redesign certain products or discontinuing the sale of certain products.

*NXP may from time to time make acquisitions and engage in other transactions to complement or expand its existing businesses. However, NXP may not be successful in acquiring suitable targets at acceptable prices and integrating them into its operations.*

NXP's future success may depend on acquiring businesses and technologies, making investments or forming joint ventures that complement, enhance or expand its current portfolio or otherwise offer growth opportunities. If NXP is unable to identify suitable targets, its growth prospects may suffer, and it may not be able to realize sufficient scale advantages to compete effectively in all markets. NXP may also face challenges in successfully integrating acquired companies into its existing organization.

*NXP may from time to time exit certain product lines or businesses, or to restructure its operations, but may not be successful in doing so.*

From time to time, NXP may decide to divest certain product lines and businesses or restructure its operations. However, NXP's ability to exit a product line or business in a timely manner or to restructure its operations in a manner it deems to be advantageous, depends on a number of factors, many of which are outside of its control. If NXP is unable to do so, it may have an adverse effect on its business.

### Operational risks

Operational risks include adverse unexpected developments resulting from internal processes, people and systems, or from external events that are linked to the actual running of each business.

*In difficult market conditions, high fixed costs have a negative impact NXP's on operating result.*

The semiconductor industry is characterized by high fixed costs and, notwithstanding NXP's significant utilization of third-party manufacturing capacity, most of its production requirements are met by its own manufacturing facilities. Under difficult market conditions, NXP is generally faced with a decline in the utilization rates of its manufacturing facilities. During such periods, NXP's manufacturing plants do not operate at full capacity and the costs associated with this excess capacity are charged directly to cost of sales.

*The semiconductor industry is capital intensive and if NXP is unable to invest the necessary capital to operate and grow its business, it may not remain competitive.*

To remain competitive, NXP must constantly improve its facilities and process technologies and carry out extensive research and development, each of which requires investment of significant amounts of capital. If NXP is unable to generate sufficient cash or raise sufficient capital to meet both its debt service and capital investment requirements, or if it is unable to raise required capital on favorable terms when needed, it may have an adverse effect on its competitiveness.

*NXP's operating results may suffer if its production capacity does not match demand.*

To operate efficiently, NXP attempts to maintain its manufacturing capacity at optimum levels relative to the demand it predicts for its products. Demand for its products is subject to significant fluctuation. A significant proportion of its manufacturing capacity is fixed because it takes a substantial amount of time to build new facilities. Moreover, because NXP has adopted an "asset-light" manufacturing strategy, its ability to increase internal manufacturing capacity is limited. To the extent that production demand exceeds available manufacturing capacity, NXP attempts to increase its usage of third-party manufacturing to meet requirements.

However, there can be no assurance that third-party capacity will be available or that third-party manufacturers will have the necessary process technology.

If suppliers are unable to satisfy NXP's demand, or experience manufacturing difficulties, delays or reduced yields, operating results and ability to satisfy customer demand could suffer. Furthermore, outsourcing costs can vary materially from quarter-to-quarter and, in cases of industry shortages, they can increase significantly, negatively impacting operating results.

*Warranty and product liability claims against NXP could cause incurring significant costs and affect its reputation and relationships with key customers.*

NXP is from time to time subject to warranty and product liability claims with regard to product performance. NXP could incur product liability losses as a result of repair and replacement costs in response to customer complaints or in connection with the resolution of contemplated or actual legal proceedings relating to such claims. In addition to potential losses from claims and related legal proceedings, product liability claims could affect NXP's reputation and its relationships with key customers.

*Because NXP is dependent on its personnel for leadership and specialized skills, the loss of its ability to attract and retain such personnel could adversely affect its business.*

The retention of talented employees in manufacturing, research and development, sales and marketing is critical to the success of NXP. In addition to personnel attraction and retention, loss of specialized skills due to illness of personnel on a larger scale, as a result of, for example, SARS or bird flu, or terrorist assaults, could result in business interruptions.

*Disruptions in NXP's relationships with any one of its key customers could adversely affect its operating result.*

A substantial portion of sales of NXP is derived from its top customers. NXP cannot guarantee that it will be able to generate similar levels of sales from its largest customers in the future. Should one or more of these customers substantially reduce their purchases from NXP, its business could be adversely affected.

*The interests of our principal shareholders may be inconsistent with those of other stakeholders.*

The Consortium, subject to the provisions of the Shareholders Agreement, has the power to control our affairs and policies. Our principal shareholders may have conflicting interests with one another which may impede their ability to collectively make important decisions regarding our business. The interests of the members of the Consortium on the one hand and Philips on the other hand could also conflict with those of other stakeholders, particularly if we encounter financial difficulties or are unable to pay our debts when due. In addition, our principal shareholders and their respective affiliates could have an interest in pursuing acquisitions, divestitures, financings or other transactions that, in their judgment, would enhance their equity investments, and their respective affiliates may own, acquire and hold interests in businesses that compete directly or indirectly with us or may own businesses with interests that conflict with ours.

## Financial risks

Within the area of financial risks, NXP identifies risks related to Legal, Treasury, Pensions and Fiscal. Compliance and financial reporting risks cover unanticipated failures to enact appropriate policies and procedures, and risks that could negatively impact NXP's reliability of financial reporting, accuracy of disclosures and safeguarding of assets.

***NXP is exposed to a variety of financial risks, including currency risk, interest rate risk, liquidity risk, commodity price risk, credit risk, country risk and other insurable risks, which may impact NXP's results.***

NXP is a global company and as a direct consequence its financial results may be impacted through currency fluctuations. Furthermore, NXP is exposed to other movements in the financial markets in the form of interest rate risk and commodity price risk. For further analysis, please refer to "details of financial risks".

***NXP has defined-benefit pension plans in a number of countries. The funded status and the cost of maintaining these plans are influenced by financial market and demographic developments, which may lead to volatility in NXP's results.***

The majority of employees in Europe are covered by such plans. The accounting for defined-benefit pension plans requires management to determine discount rates, expected rates of compensation and expected returns on plan assets. Changes in these variables can have a significant impact on the projected benefit obligations and net periodic pension costs. A negative performance of the financial markets could have a material impact on funding requirements and net periodic pension costs. For further analysis, please refer to "details of financial risks".

***NXP is exposed to a number of different tax uncertainties, which could have a significant impact on local tax results.***

NXP is exposed to foreign taxation, and penalties, including interest payments. Uncertainties created by this exposure relate to transfer pricing of internal deliveries of goods and services or in financing, acquisitions and divestments, the use of tax credits and permanent establishments, and losses carried forward. These uncertainties may have a significant impact on local tax results. For further analysis, please refer to "details of financial risks".

***Legal proceedings covering a range of matters are pending in various jurisdictions against NXP. Due to the uncertainty inherent in litigations, it is difficult to predict the final outcome. An adverse outcome might impact NXP's results.***

The Company and certain of its businesses are involved as plaintiffs or defendants in legal proceedings in various matters. Although the ultimate disposition of asserted claims and proceedings cannot be predicted with certainty, NXP's financial position and results of operations could be affected by an adverse outcome.

## Compliance and financial reporting risks

***Reliability of reporting, accuracy of disclosures and safeguarding of assets.***

Reliability of reporting is a pre-requisite for management to steer the business. Flaws in control systems could adversely affect the financial results and hamper expected growth. The accuracy of disclosures affects investor's and other market professional's understanding of NXP's businesses. Imperfections in the disclosures could create uncertainty regarding the reliability of the data presented. Compliance procedures are adopted by management to ensure that the resource use is consistent with laws, regulations and policies, and that resources are safeguarded against waste, loss and misuse. Ineffective compliance procedures relating to the safeguarding of assets could have an undesirable effect on the financial results.

## Details of financial risks

This section provides further details of the financial risks, which are categorized along the lines of the corporate processes.

### ***Treasury***

NXP is exposed to several types of financial risks. The financial risks relate to adverse changes in market prices, including commodity prices, foreign currency exchange and interest rates, and of financial instruments. We enter into diverse financial transactions with several counterparties to mitigate our risk. Derivative instruments are only used for hedging purposes.

*Currency risk*

A substantial proportion of our cost base is incurred in euros, while most of our revenues are denominated in US dollars. Accordingly, our results of operations may be affected by changes in foreign currency exchange rates, particularly between the euro and the US dollar. A weakening US dollar against the euro during any reporting period will reduce EBIT of NXP.

It is NXP's policy that material transaction exposures are hedged. Accordingly, the Company's organizations identify and measure their exposures from material transactions denominated in other than their own functional currency.
We calculate our net exposure on a cash flow basis considering balance sheet items, actual orders received or made and anticipated revenues and expenses. Committed foreign currency exposures are required to be fully hedged using forward contracts. The net exposures related to anticipated transactions are hedged up to 70% for a maximum tenor of 24 months.
The translation exposures related to foreign currency denominated debt are not hedged.

The table below outlines the foreign currency transactions outstanding per December 31, 2006

| In millions of euro equivalents | Aggregate Contract amount buy/ (sell) [1] | Fair value December 31, 2006 [1] | Weighted Average Tenor (in months) |
|---|---|---|---|
| Foreign currency forward contracts[1] | | | |
| Euro/ US dollar | 550 | 6.00 | 8.3 |
| US dollar/ Japanese Yen | (16) | 0.01 | 4 |
| Great Britain pound/ US dollar | 18 | 0.22 | 2 |
| US dollar/ Swedish kroner | (7) | (0.26 ) | 1.5 |
| US dollar/ Singapore dollar | (9) | 0.05 | 1.5 |
| US dollar/ Thailand baht | 7 | (0.13 ) | 1 |
| US dollar/ Malaysian Ringgit | 15 | (0.05 ) | 1 |
| Euro/ Great Britain pound | 17 | 0.10 | 1 |
| Euro/ Polish zloty | 29 | 0.15 | 1 |

[1] euro equivalent

The derivatives related to transactions are, for hedge accounting purposes, split into hedges of accounts receivable/payable and anticipated sales and purchases. Changes in the value of foreign currency accounts receivable/payable as well as the changes in fair value of the hedges of accounts receivable/payable are reported in the income statement under cost of sales.
Hedges related to anticipated transactions are accounted for as cash flow hedges. The results of such hedges are deferred in other comprehensive income within equity. Currently, a gain of EUR 6 million is deferred in equity as a result of these hedge transactions. The results from such hedges are released to income from operations when the related transactions affect the income statements.

*Interest rate risk*

NXP has significant outstanding debt, which creates an inherent interest rate risk. On October 12, 2006, NXP issued several series of notes with maturities ranging from 7 to 9 years and a mix of floating and fixed rates. The euro and US dollar denominated notes represent 34.4% and 65.6% respectively of the total notes outstanding.

The following table summarizes the outstanding notes per December 31, 2006:

| | Principal amount * | Fixed/ floating | Current coupon rate | Maturity date |
|---|---|---|---|---|
| Senior Secured Notes | EUR 1,000 | Floating | 6.214 | 2013 |
| Senior Secured Notes | USD 1,535 | Floating | 8.118 | 2013 |
| Senior Secured Notes | USD 1,026 | Fixed | 7.875 | 2014 |
| Senior Notes | EUR 525 | Fixed | 8.625 | 2015 |
| Senior Notes | USD 1,250 | Fixed | 9.500 | 2015 |

* amount in millions

A sensitivity analysis shows that if interest rates were to increase instantaneously by 1% from the level of December 31, 2006, all other variables held constant, the annualized net interest expense would increase by EUR 15 million. This impact is based on the outstanding net debt position as per December 31, 2006.

*Liquidity risk*

The rating of the Company's debt by major rating agencies may improve or deteriorate. As a result, NXP's borrowing capacity and financing costs may be impacted. NXP has various sources to mitigate such risk including a EUR 500 million committed revolving credit facility (maturing in 2012) and its cash on hands.

*Commodity price risk*

NXP is a purchaser of certain base metals, precious metals and energy used in the manufacturing process of our products. Currently NXP does not use financial derivative instruments to manage such exposure to fluctuations in commodity prices.

*Credit Risk*

Credit risk represents the loss that would be recognized at the reporting date if counterparties failed to perform upon the agreed payment obligations. Credit risk is present within the trade receivables of NXP. Such exposure is reduced through ongoing credit evaluations of the financial conditions of our customers and by adjusting payment terms and credit limits when appropriate.

NXP invests available cash and cash equivalents with various financial institutions and is in that respect exposed to credit risk with these counterparties. NXP actively manages concentration risk on a daily basis adhering to a treasury management policy. Cash is invested and financial transactions are concluded where possible with financial institutions with a strong credit rating. As of December 31, 2006 most of the Company's cash was placed in short-term deposits, with financial institutions with a rating of at least AA-.

*Insurable risks.*

Global insurance policies are in place to cover NXP for possible losses resulting from various types of risks in the areas of property damage, business interruption, general and product liability, transport, directors and officers liability, employment practice liability, and criminal liability. To lower exposures and to avoid potential losses, NXP has a worldwide Risk Engineering program in place. The main focus in this program is on property damage and business interruption risks.

### *Pensions*

NXP has defined-benefit pension plans in a number of countries. The funded status and the cost of maintaining these plans are influenced by financial market and demographic developments, which may create volatility in NXP's results.
The majority of employees in Europe and the USA are covered by these plans. The accounting for defined-benefit plans requires management to determine discount rates, expected rates of compensation and expected return on plan assets. Changes in these variables can have a significant impact on the projected benefit obligations and net periodic pension cost. A negative performance of the financial markets could have a material impact on funding requirements and net periodic pension cost and also affect the value of certain financial assets of the Company. For quantitative and qualitative disclosure of pensions, please refer to note 22 to the combined and consolidated financial statements.

## Risks related to our Separation from Philips

*Our historical results may not be representative of our future results as a separate, stand-alone company.*

Our predecessor combined financial statements and the other financial information we have included in this report have been derived from the consolidated financial statements of Philips and its accounting records and do not necessarily reflect what our results of operations, financial condition and cash flows would have been had we operated as a separate, stand-alone company during the periods presented in this report.

Philips did not account for us, and we were not operated, as a separate, stand-alone company for the predecessor periods presented. The historical costs and expenses reflected in our combined financial statements include an allocation for certain corporate functions historically provided to us by Philips, including legal, finance, human resources and other administrative functions. These allocations are based on what we consider to be reasonable reflections of the historical utilization levels of these functions required in support of our business.

Moreover, our predecessor combined financial statements and the other historical financial information included in this report do not necessarily indicate what our results of operations, financial condition, cash flows or costs and expenses will be in the future. In particular, our combined financial statements do not reflect the costs to us of borrowing funds as a separate entity. Our pension plan costs and liabilities, tax rate and cash taxes paid may also increase significantly as a result of setting up our stand-alone plans. For more information on our results of operations, financial condition and cash flows, please refer to the combined and consolidated financial statements and the accompanying notes included in this report.

### *Fiscal*

NXP has issued transfer pricing directives in the area of goods, services and financing, which are in accordance with the Guidelines of the Organization of Economic Co-operation and Development. As transfer pricing has a cross border effect, the focus of local tax authorities on implemented transfer pricing procedures in a country may have an impact on results in another country.

In order to mitigate the transfer pricing uncertainties within NXP deployment measures have been taken and a monitoring system has been put in place. On a regular basis audits are executed to test the correct implementation of the transfer pricing directives. NXP has various tax assets partly resulting from the acquisition of its business from Philips or from other acquisitions. Tax assets can also result from the generation of tax losses in certain legal entities. The value of the tax assets resulting from tax losses carried forward depends on having sufficient profits available in the future.

## Critical accounting policies

The preparation of financial statements and related disclosures in accordance with accounting principles generally accepted in the United States requires our management to make judgments, assumptions and estimates that affect the amounts reported in our combined (predecessor) financial statements, our consolidated (successor) financial statements and the accompanying notes. The critical accounting policies as described in this section are related to both the predecessor financial statements as well as the successor financial statements unless stated otherwise. Our management bases its estimates and judgments on historical experience, current economic and industry conditions and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. If actual results differ significantly from management's estimates, there could be a material adverse effect on our results of operations, financial condition and liquidity.

The combined financial statements of our predecessor period have been derived from the consolidated financial statements of Philips and principally represent the semiconductors segment. We were historically operated as a segment of Philips and a number of services were provided to us by Philips. These include certain corporate functions such as management oversight and brand campaigns, basic research and IP services. In addition, we participated in Philips pension plans, overall treasury management and tax planning strategies.

We have estimated the cost of all such services and have recorded these amounts in our combined financial statements. These estimates are subject to significant judgment and have had a material impact on our combined financial statements. The combined financial statements of our predecessor period do not reflect the impact of our acquisition by KASLION Acquisition B.V. There has been a significant impact on our financial results as a result of accounting for the acquisition, the purchase price for which has been pushed-down to NXP B.V., the parent company of the NXP Semiconductors Group. Our significant accounting policies are summarized in the section Accounting Policies under note 3 of our consolidated financial statements. Summarized below are those of our accounting policies where management believes the nature of the estimates or assumptions involved is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change.

***Inventories***

Inventories are stated at the lower of cost or market. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, taking into account the stage of completion. The cost of inventories is determined using the first-in, first-out (FIFO) method. In determining the value of our inventories, estimates are made of material, labor and overhead consumed. In addition, our estimated yield has a significant impact on the valuation. We estimate yield based on historical experience.

An allowance is made for the estimated losses due to obsolescence. This allowance is determined for groups of products based on purchases in the recent past and/or expected future demand.

***Impairment***

We review long-lived assets for impairment when events or circumstances indicate that carrying amounts may not be recoverable. Assets subject to this review include equity and security investments, definite life intangible assets and tangible fixed assets. Impairment of equity and security investments results in a charge to income when a loss in the value of an investment is deemed to be other than temporary.

Management regularly reviews equity investments for impairment based on the extent to which cost exceeds market value, the duration of decline in market value and the financial condition. In determining impairments of intangible assets and tangible fixed assets, management must make significant judgments and estimates to determine whether the cash flows generated by those assets are less than their carrying value. Determining cash flows requires the use of judgments and estimates that have been included in the Company's strategic plans and long-range forecasts. The data necessary for the execution of the impairment tests are based on management estimates of future cash flows, which require estimating revenue growth rates and profit margins. For our IC Manufacturing Operations segment, the review of impairment of long-lived assets is carried out on a company-wide basis, as IC Manufacturing Operations is the shared manufacturing base for the other business units with no discrete cash flows that are largely independent of other cash flows.

Assets other than goodwill are written down to their fair value when the value of their undiscounted cash flows are less than the carrying value of the assets. The fair value of impaired assets is generally determined by taking into account these estimated cash flows and using a present value technique for discounting these cash flows.

Goodwill is evaluated at least annually for impairment at business unit level, and written down to its implied fair value, in the case of impairment. The determination of such implied fair value involves significant judgment and estimates from management.
Changes in assumptions and estimates included within the impairment reviews could result in significantly different results than those recorded in the combined and consolidated financial statements.

***Restructuring***

The provision for restructuring relates to the estimated costs of initiated reorganizations that have been approved by our Board of Management and that involve the realignment of certain parts of the industrial and commercial organization. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in restructuring provisions.

Management uses estimates to determine the amount of restructuring provision. Our estimates are based on our anticipated personnel reductions and average associated costs. These estimates are subject to judgment and may need to be revised in future periods based on additional information and actual costs.

***Revenue Recognition***

The Company's revenues are primarily derived from made-to-order sales to original equipment manufacturers ("OEM"s) and similar customers. A smaller portion of the Company's revenues is derived from sales to distributors.

The Company applies the guidance in SEC Staff Accounting Bulletin Topic 13 "Revenue Recognition" and recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or the service has been provided, the sales price is fixed or determinable, and collection is reasonably assured, based on the terms and conditions of the sales contract. For "made to order" sales, these criteria are generally met at the time the product is shipped and delivered to the customer and title and risk have passed to the customer. Examples of delivery conditions typically meeting these criteria are 'Free on Board point of delivery' and 'Costs, Insurance Paid point of delivery'. Generally, the point of delivery is the customer's warehouse. Acceptance of the product by the customer is generally not contractually required, since, with "made-to-order" customers, design approval commences manufacturing and delivery without further acceptance protocols. Payment terms used are those that are customary in the particular geographic market. When management has established that all aforementioned conditions for revenue recognition have been met and no further post-shipment obligations exist revenue is recognized.

For sales to distributors, the same recognition principles apply and similar terms and conditions as for sales to other customers are applied. However, for some distributors, contractual arrangements are in place that allow these distributors to return product if certain conditions are met. These conditions generally relate to the time period during which return is allowed and reflect customary conditions in the particular geographic market. Other return conditions relate to circumstances arising at the end of a product cycle, when certain distributors are permitted to return products purchased during a pre-defined period after the Company has announced a product's pending discontinuance. Long notice periods associated with these announcements generally prevent significant amounts of product from being returned, however. Repurchase agreements with OEM's or distributors are generally not entered into by the Company.

For sales where return rights exist, the Company applies the guidance given in SFAS 48 "Recognition When Right of Return Exists." Based on historical data, management has determined that only a very small percentage of the sales to this type of distributors is actually returned. Currently the return percentage is less than 1%. In accordance with the requirements of SFAS 48, a pro rata portion of the sales to these distributors is not recognized but deferred until the return period has lapsed or the other return conditions no longer apply. Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. Shipping and handling costs billed to customers are recognized as revenues. Expenses incurred for shipping and handling costs of internal movements of goods are recorded as cost of sales. Shipping and handling costs related to sales to third parties are reported as selling expenses.

Royalty income, which is generally earned based upon a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis. Government grants, other than those relating to purchases of assets, are recognized as income as qualified expenditures are made.

A provision for product warranty is made at the time of revenue recognition and reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to the sold products. In cases where the warranty period is extended and the customer has the option to purchase such an extension, which is subsequently billed separately to the customer, revenue recognition occurs on a straight-line basis over the contract period.

***Income Taxes***

The Company's income taxes as presented in the predecessor combined financial statements were calculated on a separate tax return basis, although the Company was included in the consolidated tax return of Philips. Philips manages its tax position for the benefit of its entire portfolio of businesses, and its tax strategies are not necessary reflective of the tax strategies that the Company would have followed or will follow as a stand-alone Company.

Income taxes in the successor consolidated financial statements are accounted for using the asset and liability method. We operate in numerous countries where our income tax returns are subject to audits and adjustments. Because we operate globally, the nature of the audit items are often very complex. We employ internal and external tax professionals to minimize audit adjustment amounts where possible.

We exercise judgment in determining the extent of the realization of the net operating losses (NOLs) based upon estimates of future taxable income in the various jurisdictions in which these NOLs exist. Where there is an expectation that on the balance of probabilities there will not be sufficient taxable profits to utilize these NOLs a valuation allowance has been made against these deferred tax assets. If actual events differ from management's estimates, or to the extent that these estimates are adjusted in the future, any changes to the valuation allowance could materially impact the Company's financial position and results.

*Benefit Accounting*

Currently and following the Separation the Company's employees participate in pension and other postretirement benefit plans that Philips has established in many countries.
The costs of pension and other postretirement benefits and related assets and liabilities with respect to the Company employees participating in these plans have been allocated to the Company based upon actuarial computations.

In addition to Philips-sponsored plans, we have approximately five defined-benefit pension plans in which only our employees participate. We record the assets and liabilities associated with these plans in our balance sheet, and record the actuarially determined pension costs each period. Pension costs in respect of defined-benefit pension plans primarily represent the increase in the actuarial present value of the obligation for pension benefits based on employee service during the year and the interest on this obligation in respect of employee service in previous years, net of the expected return on plan assets.

In calculating obligation and expense, we are required to select certain actuarial assumptions. These assumptions include discount rate, expected long-term rate of return on plan assets and rates of increase in compensation costs. Our assumptions are determined based on current market conditions, historical information and consultation with and input from our actuaries.

## Reconciliation of non-US GAAP information

Certain non-US GAAP financial measures are presented when discussing the NXP Group's financial position. In the following tables, a reconciliation to the most directly comparable US GAAP financial measure is made for each non-US GAAP performance measure.

### Sales growth composition

| In % | Comparable growth | Currency effects | Nominal growth |
|---|---|---|---|
| Combined and unaudited, for the year 2006 versus the year 2005 | | | |
| Mobile & Personal | (2.0) | (1.1) | (3.1) |
| Home | (4.9) | (1.0) | (5.9) |
| Automotive & Identification | 22.2 | (0.8) | 21.4 |
| MultiMarket Semiconductors | 9.6 | (1.0) | 8.6 |
| IC Manufacturing Operations | 16.3 | (1.5) | 14.8 |
| Corporate and Other | 52.5 | (1.4) | 51.1 |
| NXP Group | 5.4 | (1.3) | 4.1 |

| In % | Comparable growth | Currency effects | Nominal growth |
|---|---|---|---|
| For the period January 1, 2006 - September 28, 2006 versus the period January 1, 2006 - September 30, 2005 | | | |
| Mobile & Personal | 1.5 | 0.9 | 2.4 |
| Home | 0.4 | 0.9 | 1.3 |
| Automotive & Identification | 27.1 | 0.7 | 27.8 |
| MultiMarket Semiconductors | 12.9 | 0.9 | 13.8 |
| IC Manufacturing Operations | 47.8 | 1.6 | 49.4 |
| Corporate and Other | 29.3 | 1.0 | 30.3 |
| NXP Group | 9.7 | 0.9 | 10.6 |

| In % | Comparable growth | Currency effects | Nominal growth |
|---|---|---|---|
| For the year 2005 versus the year 2004 | | | |
| Mobile & Personal | 5.8 | 0.3 | 6.1 |
| Home | (5.9) | 0.4 | (5.5) |
| Automotive & Identification | 1.9 | (0.1) | 1.8 |
| MultiMarket Semiconductors | (2.5) | 0.1 | (2.4) |
| IC Manufacturing Operations | (18.0) | - | (18.0) |
| Corporate and Other | (50.0) | - | (50.0) |
| NXP Group | (1.4) | 0.2 | (1.2) |

### EBITA to Net income (loss)

| | PREDECESSOR | | | SUCCESSOR | COMBINED |
|---|---|---|---|---|---|
| | For the years ended December 31, 2004 | 2005 | For the period January 1, 2006 – September 28, 2006 | For the period September 29, 2006 – December 31, 2006 | For the year ended December 31, 2006 |
| EBITA | 305 | 132 | 111 | (145) | (34) |
| Include: | | | | | |
| Amortization intangible assets | (85) | (69) | (19) | (640) | (659) |
| Financial income (expenses) | (93) | (63) | (22) | (73) | (95) |
| Income taxes | (113) | (101) | (65) | 242 | 177 |
| Net income (loss) | 14 | (101) | 5 | (616) | (611) |

## Adjusted EBITDA to EBITDA to Net income (loss)

| | PREDECESSOR | | | SUCCESSOR | COMBINED |
|---|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, | For the period September 29, 2006 – December 31, | For the year ended December 31, |
| | 2004 | 2005 | 2006 | 2006 | 2006 |
| Adjusted EBITDA | 1,202 | 1,030 | 707 | 214 | 921 |
| Add back: | | | | | |
| Exit of productlines | 162 | 110 | 35 | 9 | 44 |
| Restructuring costs and impairment | 32 | 8 | 17 | 4 | 21 |
| Minority interest and results of unconsolidated companies | 14 | 39 | 47 | 6 | 53 |
| Other | (75) | (8) | 45 | 39 | 84 |
| Effects of PPA | - | - | - | 130 | 130 |
| EBITDA | 1,069 | 881 | 563 | 26 | 589 |
| Include: | | | | | |
| Amortization intangible assets | (85) | (69) | (19) | (640) | (659) |
| Depreciation property, plant and equipment | (764) | (749) | (452) | (171) | (623) |
| Financial income (expenses) | (93) | (63) | (22) | (73) | (95) |
| Income taxes | (113) | (101) | (65) | 242 | 177 |
| Net income (loss) | 14 | (101) | 5 | (616) | (611) |

## Composition of cash flows before financing activities

| | PREDECESSOR | | | SUCCESSOR | COMBINED |
|---|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, | For the period September 29, 2006 – December 31, | For the year ended December 31, |
| | 2004 | 2005 | 2006 | 2006 | 2006 |
| Cash flows from operating activities | 978 | 792 | 468 | 292 | 760 |
| Cash flows from investing activities | (590) | (358) | (457) | (184) | (641) |
| Cash flows before financing activities | 388 | 434 | 11 | 108 | 119 |

## Composition of net debt to group equity

| | SUCCESSOR 2006 |
|---|---|
| Long-term debt | 4,426 |
| Short-term debt | 23 |
| Total debt | 4,449 |
| Cash and cash equivalents | (939) |
| Net debt (cash) (total debt less cash and cash equivalents) | 3,510 |
| Minority interests | 162 |
| Shareholder's equity | 3,685 |
| Group equity | 3,847 |
| Net debt and group equity | 7,357 |
| Net debt divided by net debt and group equity (in %) | 48 |
| Group equity divided by net debt and group equity (in %) | 52 |

## Subsequent events

On January 16, 2007, NXP announced it will not extend its current cooperation in the Crolles2 alliance beyond the initial term expiring at the end of 2007. NXP will work together with the alliance partners in 2007 to complete the current program and effectively manage the transition.

On February 8, 2007, NXP announced the agreement to acquire the Cellular Communications Business of Silicon Laboratories Inc. for an amount of USD 285 million in cash. NXP may pay up to an additional USD 65 million contingent upon the achievement of certain milestones in the next three years. This acquisition was completed on March 23, 2007.

On March 22, 2007, NXP announced the closure of the Böblingen operation in Germany and the reorganization of its back-end operations in the Philippines.

On April 27, NXP launched an offer to exchange its outstanding Fixed and Floating Rate Notes for identical notes registered under the U.S. Securities Act. NXP announced on June 19, 2007 the closing of this exchange. The exchanges have no effect on NXP's capitalization or debt outstanding.

On May 14, 2007 NXP and DSP Group, Inc. announced that they will combine their Cordless & VoIP terminals product lines within the DSP Group. The DSP Group will pay USD 270 million, consisting of USD 200 million in cash and USD 70 million in the issuance of DSP Group's common stock. The DSP Group has also agreed to a contingent cash payment of up to USD 75 million, based on future revenue performance. The transaction is expected to close in the third quarter of 2007, subject to closing conditions, including regulatory approvals.

## Outlook

The market remains soft. Given our book-to-bill ratio of 1.02 in the second quarter of 2007 we expect low to mid single digit sequential sales growth for the third quarter 2007 on a currency comparable basis. We believe we are well positioned to benefit from a next upturn in the relevant semiconductor market segments.

Eindhoven, July 18, 2007
*Board of Management*

## Combined and consolidated statements of operations of the NXP Semiconductors Group

in millions of euros unless otherwise stated

| | | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|---|
| | | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | | 2004 | 2005 | 2006 | **2006** |
| | Sales | 4,609 | 4,615 | 3,702 | **1,172** |
| | Sales to Philips companies | 214 | 151 | 68 | **18** |
| | Total sales | 4,823 | 4,766 | 3,770 | **1,190** |
| | Cost of sales | (2,955) | (2,933) | (2,331) | **(917)** |
| | **Gross margin** | 1,868 | 1,833 | 1,439 | **273** |
| | Selling expenses | (297) | (304) | (275) | **(88)** |
| | General and administrative expenses | (437) | (435) | (306) | **(194)** |
| | Research and development expenses | (979) | (1,028) | (737) | **(258)** |
| 18 | Write-off of acquired in-process research and development | - | - | - | **(515)** |
| | Other income | 79 | 36 | 18 | **3** |
| 7,8 | **Income (loss) from operations** | 234 | 102 | 139 | **(779)** |
| 9 | Financial income (expense) | (93) | (63) | (22) | **(73)** |
| | **Income (loss) before taxes** | 141 | 39 | 117 | **(852)** |
| 10 | Income tax (expense) benefit | (113) | (101) | (65) | **242** |
| | **Income (loss) after taxes** | 28 | (62) | 52 | **(610)** |
| 11 | Results relating to unconsolidated companies | 12 | (5) | 3 | **(2)** |
| 12 | Minority interests | (26) | (34) | (50) | **(4)** |
| | **Net income (loss)** | 14 | (101) | 5 | **(616)** |

The accompanying notes are an integral part of these combined and consolidated financial statements.

## Combined and consolidated balance sheets of the NXP Semiconductors Group

in millions of euros unless otherwise stated

### Assets

| Note | | PREDECESSOR December 31, 2005 | | SUCCESSOR December 31, 2006 | |
|---|---|---|---|---|---|
| | **Current assets** | | | | |
| | Cash and cash equivalents | | 110 | | 939 |
| 5,13 | Receivables: | | | | |
| | - Accounts receivable – net | 534 | | 501 | |
| | - Accounts receivable from Philips companies | 34 | | 49 | |
| | - Other receivables | 21 | | 13 | |
| | | | 589 | | 563 |
| 14 | Inventories | | 696 | | 646 |
| 15 | Other current assets | | 106 | | 125 |
| | Total current assets | | 1,501 | | 2,273 |
| | **Non-current assets** | | | | |
| 11 | Investments in unconsolidated companies | | 48 | | 44 |
| 16 | Other non-current financial assets | | 7 | | 12 |
| 16 | Other non-current assets | | 122 | | 157 |
| 17,28 | Property, plant and equipment: | | | | |
| | - At cost | 7,688 | | 2,455 | |
| | - Less accumulated depreciation | (5,632) | | (171) | |
| | | | 2,056 | | 2,284 |
| 18 | Intangible assets excluding goodwill: | | | | |
| | - At cost | 527 | | 3,190 | |
| | - Less accumulated amortization | (469) | | (125) | |
| | | | 58 | | 3,065 |
| 19 | Goodwill | | 213 | | 2,032 |
| | Total non-current assets | | 2,504 | | 7,594 |
| | **Total** | | 4,005 | | 9,867 |

The accompanying notes are an integral part of these combined and consolidated financial statements.

## Liabilities and business' and shareholder's equity

| Note | | PREDECESSOR December 31, 2005 | | SUCCESSOR December 31, 2006 | |
|---|---|---|---|---|---|
| | **Current liabilities** | | | | |
| 5 | Accounts payable: | | | | |
| | - Trade creditors | 415 | | 446 | |
| | - Accounts payable to Philips companies | 55 | | 43 | |
| | | | 470 | | 489 |
| 20 | Accrued liabilities | | 548 | | 485 |
| 21,22,23,29 | Short-term provisions | | 53 | | 54 |
| 24 | Other current liabilities | | 55 | | 45 |
| 25 | Short-term debt | | 147 | | 23 |
| 5 | Loans with Philips companies, current portion | | 610 | | - |
| | Total current liabilities | | 1,883 | | 1,096 |
| | **Non-current liabilities** | | | | |
| 26,28 | Long-term debt | | 224 | | 4,426 |
| 5 | Loans with Philips companies, non-current portion | | 502 | | - |
| 21,22,23,29 | Long-term provisions | | 88 | | 368 |
| 27 | Other non-current liabilities | | 9 | | 130 |
| | Total non-current liabilities: | | 823 | | 4,924 |
| 28,29 | Commitments and contingent liabilities | | | | |
| 12 | Minority interests | | 173 | | 162 |
| | Business' equity (Predecessor): | | | | |
| | Philips net investment | 1,350 | | | |
| | Accumulated other comprehensive loss | (224) | | | |
| | Total Business' equity | | 1,126 | | |
| | Shareholder's equity (Successor): | | | | |
| | Common stock (issued and authorized: 1,000 shares, no par value) | | | - | |
| | Capital in excess of par value | | | 4,305 | |
| | Accumulated deficit | | | (616) | |
| | Accumulated other comprehensive loss | | | (4) | |
| | Total Shareholder's equity | | | | 3,685 |
| | **Total** | | 4,005 | | 9,867 |

## Combined and consolidated statements of cash flows of the NXP Semiconductors Group

in millions of euros unless otherwise stated

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| *Cash flows from operating activities:* | | | | |
| **Net income (loss)** | 14 | (101) | 5 | **(616)** |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 849 | 818 | 471 | **296** |
| Write-off of in-process research and development | | | | **515** |
| Net gain on sale of assets | (20) | (17) | (7) | **(4)** |
| Results relating to unconsolidated companies | (3) | 5 | (3) | **2** |
| Minority interests | 26 | 34 | 50 | **4** |
| *Changes in operating assets and liabilities:* | | | | |
| (Increase) decrease in receivables and other current assets | (32) | (52) | (131) | **266** |
| (Increase) decrease in inventories | (47) | 29 | (68) | **168** |
| Increase (decrease) in accounts payable, accrued and other liabilities | 88 | 95 | 154 | **(3)** |
| Decrease (increase) in current accounts Philips | 33 | 15 | (25) | **-** |
| Decrease (increase) in non-current receivables/ other assets | 38 | (21) | (24) | **(82)** |
| Increase (decrease) in provisions | 16 | (31) | 33 | **(206)** |
| Other items | 16 | 18 | 13 | **(48)** |
| **Net cash provided by operating activities** | 978 | 792 | 468 | **292** |
| *Cash flows from investing activities:* | | | | |
| Purchase of intangible assets | (21) | (18) | (12) | **(5)** |
| Capital expenditures on property, plant and equipment | (641) | (370) | (465) | **(111)** |
| Proceeds from disposals of property, plant and equipment | 63 | 50 | 26 | **22** |
| Purchase of other non-current financial assets | - | - | (3) | **(2)** |
| Purchase of interest in businesses | - | (27) | (3) | **(93)** |
| Proceeds from sale of interests in unconsolidated businesses | 9 | 7 | - | **5** |
| **Net cash used for investing activities** | (590) | (358) | (457) | **(184)** |
| *Cash flows from financing activities:* | | | | |
| *PREDECESSOR* | | | | |
| Net decrease in debt | (102) | (119) | (322) | |
| Net draws (repayments) of loans to Philips companies | (19) | (39) | (497) | |
| Net transactions with Philips | (327) | (250) | 867 | |
| *SUCCESSOR* | | | | |
| Increase in short-term debt | | | | **17** |
| Proceeds from bridge loan facility, net | | | | **4,400** |
| Repayment of loan Philips, net of settlements | | | | **(3,704)** |
| Principal payments on long-term debt (incl. bridge loan) | | | | **(4,540)** |
| Proceeds from the issuance of notes | | | | **4,529** |
| **Net cash provided by (used for) financing activities** | (448) | (408) | 48 | **702** |
| Effect of changes in consolidations on cash positions | 117 | - | - | **-** |
| Effect of changes in exchange rates on cash positons | (6) | 9 | (10) | **(30)** |
| Increase in cash and cash equivalents | 51 | 35 | 49 | **780** |
| Cash and cash equivalents at beginning of period | 24 | 75 | 110 | **159** |
| **Cash and cash equivalents at end of period** | 75 | 110 | 159 | **939** |
| *Supplemental disclosures to combined and consolidated statements of cash flows* | | | | |
| **Net cash paid during the period for:** | | | | |
| Interest | 88 | 61 | 19 | **19** |
| Income taxes | 26 | 33 | 20 | **15** |
| **Net gain on sale of assets:** | | | | |
| Cash proceeds from the sale of assets | 72 | 57 | 26 | **27** |
| Book value of these assets | (52) | (40) | (19) | **(23)** |
| | 20 | 17 | 7 | **4** |

For a number of reasons, principally the effects of translation differences and consolidation changes, certain items in the statements of cash flows do not correspond to the differences between the balance sheet amounts for the respective items.
The accompanying notes are an integral part of these combined and consolidated financial statements.

## Combined and consolidated statements of changes in business' and shareholder's equity and comprehensive income (loss) of the NXP Semiconductors Group

in millions of euros unless otherwise stated

| | Philips net investment | Accumulated other comprehensive income (loss): Currency translation differences | Accumulated other comprehensive income (loss): Changes in fair value of cash flow hedges | Total business' equity |
|---|---|---|---|---|
| PREDECESSOR | | | | |
| **Balance as of December 31, 2003** | 1,967 | (221) | 6 | 1,752 |
| Net income | 14 | | | 14 |
| Current period change | | (16) | 11 | (5) |
| Reclassifications into income | | | (4) | (4) |
| Income tax on current period changes | | | (2) | (2) |
| Total comprehensive income (loss), net of tax | 14 | (16) | 5 | 3 |
| Net transactions with Philips | (297) | | | (297) |
| **Balance as of December 31, 2004** | **1,684** | **(237)** | **11** | **1,458** |
| Net loss | (101) | | | (101) |
| Current period change | | 31 | (52) | (21) |
| Reclassifications into income (loss) | | | 10 | 10 |
| Income tax on current period changes | | | 13 | 13 |
| Total comprehensive income (loss), net of tax | (101) | 31 | (29) | (99) |
| Net transactions with Philips | (233) | | | (233) |
| **Balance as of December 31, 2005** | **1,350** | **(206)** | **(18)** | **1,126** |
| Net income | 5 | | | 5 |
| Current period change | | (28) | 28 | - |
| Income tax on current period changes | | | (8) | (8) |
| Total comprehensive income (loss), net of tax | 5 | (28) | 20 | (3) |
| Net transactions with Philips | 854 | | | 854 |
| **Balance as of September 28, 2006** | **2,209** | **(234)** | **2** | **1,977*** |

* The business' equity amount of EUR 1,977 million, representing the net assets of NXP as of September 28, 2006, does not correspond to the amount of EUR 2,590 million presented as net assets before purchase price allocation as of September 29, 2006 in note 2, "Purchase price accounting', as this latter amount reflects the actual assets actually acquired and liabilities assumed at Acquisition date.

| | Common stock | Capital in excess of par value | Retained earnings | Accumulated other comprehensive income (loss): Currency translation differences | Accumulated other comprehensive income (loss): Changes in fair value of cash flow hedges | Total share-holder's equity |
|---|---|---|---|---|---|---|
| SUCCESSOR | | | | | | |
| **Balance as of September 29, 2006** | - | 4,305 | - | - | - | 4,305 |
| Net loss | | | (616) | | | (616) |
| Current period change | | | | (10) | 6 | (4) |
| Income tax on current period changes | | | | | | - |
| Total comprehensive income, net of tax | | | (616) | (10) | 6 | (620) |
| **Balance as of December 31, 2006** | - | 4,305 | (616) | (10) | 6 | 3,685 |

The accompanying notes are an integral part of these combined and consolidated financial statements.

# Notes to the combined and consolidated financial statements of the NXP Semiconductors Group

All amounts in millions of euros unless otherwise stated

## 1 Background, Basis of Presentation

### Background

On September 29, 2006, Koninklijke Philips Electronics N.V. ("Philips") sold 80.1% of its semiconductors businesses to a consortium of private equity investors ("Private Equity Consortium") in a multi-step transaction. As part of this sale, Philips transferred these semiconductor businesses to NXP B.V. ("NXP" or the "Company", formerly known as Philips Semiconductors International B.V.), a wholly owned subsidiary of Philips, on September 28, 2006. This transaction is referred to as the "Separation". All of NXP's issued and outstanding shares were then acquired by KASLION Acquisition B.V. ("KASLION"), which was formed as an acquisition vehicle by the Private Equity Consortium and Philips. This transaction is referred to as the "Acquisition". In order to fund the acquisition of NXP by KASLION, the Private Equity Consortium and Philips contributed cash to KASLION in exchange for 80.1% and 19.9%, respectively, of the total equity of KASLION.

As a result of the Separation and Acquisition, the balance sheets, statements of operations, cash flows and business' and shareholder's equity and related notes to the financial statements are presented on a Predecessor and Successor basis: The predecessor periods reflect the combined financial results of NXP prior to the Acquisition. The successor period reflects the consolidated financial results after the Acquisition. The Company also refers to the operations of NXP for both the predecessor and successor periods as NXP Semiconductors Group.

### Basis of Presentation

The combined and consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The preparation of financial statements in conformity with US GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Predecessor periods*

The combined financial statements of the Company for the Predecessor periods, represent the financial statements of NXP B.V. together with the combined financial statements of the semiconductor businesses of Philips and have been derived from the consolidated financial statements and accounting records of Philips, principally using the historical results of operations, the historical basis of assets and liabilities of the semiconductor businesses. Additionally, the combined financial statements include an allocation of the costs of certain corporate functions (management oversight, corporate services, basic research costs, brand campaign expenses, employee benefits and incentives including pensions) historically provided by Philips but not recorded by its semiconductors businesses. Additionally, the combined financial statements include allocated cash, debt and related interest income and expense, which have not been historically reported by Philips' semiconductors businesses. Furthermore, the combined financial statements present income taxes calculated on a basis as if the Company had filed a separate income tax return.

These allocations were made on a specifically identifiable basis or using relative percentages, as compared to Philips' other businesses, of the Company's net sales, payroll, fixed assets, inventory, net assets, excluding debt, headcount or other reasonable methods. Management believes the assumptions underlying the combined financial statements to be a reasonable reflection of the utilization of services provided by Philips. However, the costs the Company would have incurred or will incur as a separate stand-alone company may be higher or lower than the cost allocations reflected in these combined financial statements for the predecessor periods. In determining these estimates, management has retained the historical cost allocated by Philips where no more reliable estimate of the costs are available (for example, pension cost).

Additionally, during the predecessor periods Philips used a worldwide centralized cash management and finance function, with the activity between Philips and the Company reflected in Philips' net investment. Accordingly, the accompanying combined financial statements may not necessarily reflect the Company's results of operations, financial position and cash flows in the future or what its results of operations, financial position and cash flows would have been if the Company had been a stand-alone company during the Predecessor periods.

Since a direct ownership relationship did not exist among the various worldwide entities comprising the Company prior to the legal separation from Philips, Philips' net investments in the Company is shown as Business' equity in lieu of Shareholder's equity in the combined financial statements for the predecessor periods. Transactions between NXP B.V. and Philips and its affiliates have been identified in the combined financial statements as transactions between related parties.

*Successor period*
The consolidated financial statements include the accounts of NXP B.V. and subsidiaries during the successor period.

As a result of the purchase accounting applied to the Acquisition, the assets and liabilities reported in the consolidated balance sheet have changed substantially for the successor period as discussed in more detail in note 2. Adjustments to the final purchase price paid by KASLION to Philips are still the subject of negotiations between KASLION and Philips, and as a result changes may occur to our reported assets and liabilities. The allocation of the purchase price paid by KASLION to Philips that are reflected in our financial statements has been based on estimated fair values. In accordance with applicable accounting guidance subsequent adjustments may be required. The Company does not expect significant changes to this allocation.

## 2 Purchase price accounting

On September 29, 2006, the Company was acquired by KASLION for a purchase price of EUR 8,079 million composed of a payment of EUR 4,305 million to Philips and assumed debt of EUR 3,774 million. In accordance with the provisions of SFAS No 141 "Business Combinations" (SFAS 141), KASLION has been identified as the acquiring company and applied purchase accounting. The purchase price paid by KASLION together with the acquisition costs of EUR 45 million and estimated settlement payments for differences in agreed levels of net cash and working capital of EUR 84 million result in a total purchase price consideration of EUR 8,208 million, which has been pushed down to NXP B.V. and allocated to the fair value of assets acquired and liabilities assumed.

After the Acquisition the Company obtained a bridge loan facility of EUR 4,400 million, net of issuance cost of EUR 100 million, which was used to repay the payable to Philips, including certain cash balance settlements, amounting to EUR 3,704 million. Subsequently the bridge loan facility was repaid with the proceeds from the issuance of EUR 4,529 million of euro and USD denominated notes as described in more detail in note 26.

The Company has substantially finalized the determination of the fair values of the assets acquired and liabilities assumed and the related allocation of the purchase price. The Company has allocated the total purchase price, calculated as described above to the assets acquired and liabilities assumed based on estimated fair values. Management is responsible for determining these fair values, which reflects among other things, its consideration of valuation and appraisal reports. Revisions to the allocations of the purchase price within the time frames permitted by applicable accounting standards might affect the fair value assigned to the assets and liabilities, although no material changes to these allocations are currently expected.

The table as set forth below reflects the purchase price allocation among assets acquired and liabilities assumed:

| In millions of euros | |
|---|---|
| Aggregate purchase price | 8,208 |
| Net assets acquired and liabilities assumed at September 29, 2006 | 2,590 |
| Excess of purchase price over net assets acquired | 5,618 |
| Allocations to reflect fair value of net assets acquired: | |
| Existing technology | (1,606 ) |
| Core technology | (791 ) |
| Customer relationships | (592 ) |
| Order backlog | (47 ) |
| Trademark | (85 ) |
| In-process research and development | (515 ) |
| Property, plant and equipment | (422 ) |
| Inventories | (130 ) |
| Investments in unconsolidated companies | 10 |
| Pension liabilities | 104 |
| Deferred income tax liability | 461 |
| Allocation to goodwill | 2,005 |

The Company estimated the fair value of existing technology and core technology by applying an income analysis (which involves calculating the present value of future cash flows resulting from each asset), using an "excess earnings" method for product-related technologies, and a "relief from royalties" method for core fabrication technologies and patents. Discount rates between 11% and 28% were used in discounting cash flows, and royalty rates of between 2% and 6% were applied for purposes of the "relief from royalties" methodology.

The Company estimated the fair value of customer relationships by applying an income analysis, using an "excess earnings" approach.

Under this approach, the Company estimated its customer attrition rates and then calculated the discounted present value of the estimated cash flows resulting from selling future products to those customers over the estimated life of the customer relationship. Discount rates between 15% and 20% were applied to this analysis.

Goodwill is not amortized and will be evaluated for impairment on at least an annual basis. In-process research and development was written off immediately upon the Acquisition and, accordingly, is reflected as a loss in the consolidated statement of operations. The major categories of net assets after the purchase price allocation (PPA) (in millions of euros) were:

| | Balances after PPA |
|---|---|
| Cash & cash equivalents | 159 |
| Inventories | 825 |
| Property, plant and equipment | 2,377 |
| Intangible assets | 3,175 |
| In-process research and development | 515 |
| Goodwill | 2,005 |
| Other assets | 1,057 |
| Liabilities and debt | (1,905 ) |
| Net assets | 8,208 |

# 3 Accounting policies and new accounting standards

## Accounting policies

The combined and consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (US GAAP). Historical cost is used as the measurement basis unless otherwise indicated. The accounting policies as described in this section are used for both the combined financial statements of the Predecessor as well as the consolidated financial statements of the Successor unless otherwise indicated.

The Company applies Statement of Financial Accounting Standards (SFAS) No. 154 'Accounting Changes and Error Corrections.' This Statement establishes retrospective application as the required method for reporting a correction of an error or a change in accounting principle in the absence of explicit transition requirements for new accounting pronouncements.

## Principles for combined and consolidated financial statements

The combined financial statements for the predecessor periods include the accounts of NXP B.V. during the predecessor period a wholly-owned subsidiary of Philips, and the assets and liabilities of the semiconductor businesses of Philips. Furthermore, the combined financial statements include all entities in which the Company holds a direct or indirect controlling interest through voting rights or qualifying variable interests. The consolidated financial statements for the successor periods include the accounts of NXP B.V. and subsidiaries during the successor period a wholly-owned subsidiary of KASLION, and all entities in which the Company holds a direct or indirect controlling interest through voting rights or qualifying variable interests.

All intercompany balances and transactions have been eliminated in the combined and consolidated financial statements. Net income (loss) is reduced by the portion of the earnings of subsidiaries applicable to minority interest. The minority interests are disclosed separately in the combined and consolidated statements of operations and in the combined and consolidated balance sheets.

The Company applies Financial Accounting Standards Board (FASB) Interpretation No. 46(R) 'Consolidation of Variable Interest Entities.' In accordance with Interpretation of Accounting Research Bulletin (ARB) No. 51. 'Consolidated Financial Statements,' the Company includes in its combined and consolidated financial statements entities in which variable interests are held to an extent that would require the Company to absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

### Investments in unconsolidated companies

Investments in companies in which the Company does not have the ability to directly or indirectly control the financial and operating decisions, but does possess the ability to exert significant influence, are accounted for using the equity method. Generally, in the absence of demonstrable proof of significant influence, it is presumed to exist if at least 20% of the voting stock is owned. The Company's share of the net income of these companies is included in results relating to unconsolidated companies in the combined and consolidated statements of operations. The Company recognizes an impairment loss when an other-than-temporary decline in the value of an investment occurs.
When its share of losses exceeds the carrying amount of an investment accounted for by the equity method, the carrying amount of that investment is reduced to zero and recognition of further losses is discontinued unless the Company has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee.

### Accounting for capital transactions of a subsidiary or an unconsolidated company

The Company recognizes in income dilution gains or losses arising from the sale or issuance of stock by a subsidiary that is included in the combined and consolidated financial statements or an unconsolidated entity which is accounted for using the equity method of accounting in the combined and consolidated statement of income, unless the Company or the subsidiary either has reacquired or plans to reacquire such shares. In such instances, the result of the transaction will be recorded directly in equity.

The dilution gains or losses are presented in the combined and consolidated statement of operations under other business income if they relate to subsidiaries that are included in the combined and consolidated financial statements. Dilution gains and losses related to unconsolidated companies are presented under results relating to unconsolidated companies.

### Accounting for Alliance

Since 2002 the Company has been a participant in a jointly-funded alliance (the 'Alliance') with two other semiconductors manufacturers in Crolles, France. The activities of the Alliance are the joint development of advanced process and assembly/packaging technology and the joint operation of a fabrication plant for the manufacturing of 300 millimeter wafers. The Alliance has its own governance structure to decide on all material decisions relating to the Alliance. Each of the three participants is equally represented in the governance structure. Upon its commencement each party contributed assets to the Alliance. The initial term of the Alliance expires December 31, 2007, and will be automatically extended until December 31, 2010 unless any of the parties serves written notice of termination prior to December 31, 2006. On January 16, 2007, the Company announced its intention to withdraw from the Crolles Alliance, effective December 31, 2007.

At the termination of the Alliance, the Company retains title to the capital assets that it contributed to the Alliance unless another participant of the Alliance exercises its option to purchase those assets at the higher of net book value or market value. Capital assets contributed by the Company include primarily machinery.

Under the Alliance arrangement, each participant is responsible for funding specific allocations of operations, research and development expenses, as well as related capital expenditures and output from the facility. Funding requirements are divided among the Company (31%) and the two other participants (31% and 38%), and are accounted for to ensure all expenses and capital expenditures are recorded in relation to the funding percentage.

The Company's interest in the Alliance has been accounted for in these combined and consolidated financial statements as a contract or cost sharing arrangement.

Accordingly, the Company's share in the results of operation of the Alliance are recorded in the cost and expense caption in the accompanying combined and consolidated statement of operations, and primarily consists of the Company's share of research and development expenses, pilot line manufacturing expenses and depreciation expense related to the Alliance's capital assets.
In the accompanying combined and consolidated balance sheets the Company's share in the capital assets of the Alliance, for which it has title, is recorded in property, plant and equipment.

### Foreign currencies

The Company uses the euro as its reporting currency. The financial statements of foreign entities, with a currency other than the euro, are translated into euros. Assets and liabilities are translated using the exchange rates on the respective balance sheet dates. Income and expense items in the statements of operations and cash flows are translated at weighted average exchange rates during the year. The resulting translation adjustments are recorded as a separate component of other comprehensive income (loss) within business' and shareholder's equity. Cumulative translation adjustments are recognized as income or expense upon partial or complete disposal or substantially complete liquidation of a foreign entity.

The functional currency of foreign entities is generally the local currency, unless the primary economic environment requires the use of another currency. When foreign entities conduct their business in economies considered to be highly inflationary, they record transactions in the Company's reporting currency instead of their local currency. Gains and losses arising from foreign currency-denominated transactions, monetary assets and liabilities into the functional currency are recognized in income in the period in which they arise. However, currency differences on intercompany loans that have the nature of a permanent investment are accounted for as translation differences as a separate component of other comprehensive income (loss) within business' and shareholder's equity.

### Derivative financial instruments

The Company uses derivative financial instruments principally in the management of its foreign currency risks and to a more limited extent for interest rate and commodity price risks. In compliance with SFAS No. 133, 'Accounting for Derivative Instruments and Hedging Activities', SFAS No. 138, 'Accounting for Certain Derivative Instruments and Certain Hedging Activities', and SFAS No. 149 'Amendment of Statement 133 on Derivative Instruments and Hedging Activities,' the Company measures all derivative financial instruments based on fair values derived from market prices of the instruments or from option pricing models, as appropriate.

Changes in the fair value of a derivative that is highly effective and designated and qualifies as a cash flow hedge are recorded in accumulated other comprehensive income (loss), until earnings are affected by the variability in cash flows of the designated hedged item.

The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is established that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur within a period of two months from the originally forecasted transaction date, the Company continues to carry the derivative on the combined and consolidated balance sheets at its fair value, and gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the combined and consolidated balance sheets, and recognizes any changes in its fair value in earnings.

For interest rate swaps that are unwound, the gain or loss upon unwinding is released to income over the remaining life of the underlying financial instruments, based on the recalculated effective yield.

### Cash and cash equivalents

Cash and cash equivalents include all cash balances and short-term highly liquid investments with a maturity of three months or less at acquisition that are readily convertible into known amounts of cash. It also includes restricted cash balances that cannot be freely repatriated. Cash and cash equivalents are stated at face value.

### Receivables

Receivables are carried at face value, net of allowances for doubtful accounts and uncollectible amounts. As soon as trade accounts receivable can no longer be collected in the normal way and are expected to result in a loss, they are designated as doubtful trade accounts receivable and valued at the expected collectible amounts. They are written off when they are deemed to be uncollectible because of bankruptcy or other forms of receivership of the debtors.

### Valuation adjustment for doubtful trade accounts receivable

The allowance for the risk of non-collection of trade accounts receivable is determined in three stages. First, individual debtors that represent 3% or more of the debtor portfolio are assessed for creditworthiness based on external and internal sources of information; management decides to record an allowance based on that information and the specific circumstances for that debtor which might require a value adjustment. In the second stage, for all other debtors the allowance is calculated based on a percentage of average historical losses. Finally, if, owing to specific circumstances such as serious adverse economic conditions in a specific country or region, it is management's judgment that the valuation of the receivables is inadequately represented by the valuation allowance in stage two, the percentage of valuation allowance for the debtors in the related country or region may be increased to cover the increased risk.

### Inventories

Inventories are stated at the lower of cost or market, less advance payments on work in progress. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, taking into account the stage of completion. The cost of inventories is determined using the first-in, first-out (FIFO) method. An allowance is made for the estimated losses due to obsolescence. This allowance is determined for groups of products based on purchases in the recent past and/or expected future demand. Individual items of inventory that have been identified as obsolete are typically disposed of within a period of three months either by sale or by scrapping. Effective January 1, 2005, the Company adopted SFAS No. 151, 'Inventory costs (SFAS 151), an amendment of ARB No. 43, Chapter 4.' This Statement clarifies the accounting for abnormal amounts of idle facility expense and waste and prohibits such costs from being capitalized in inventory. In addition, this Statement requires that the allocation of fixed production overheads to the inventory cost is based on the normal capacity of the production facilities. This Statement did not have a material impact on the combined and consolidated financial statements.

### Other non-current financial assets

Loans receivable are stated at amortized cost, less the related allowance for impaired loans receivable.

### Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation. Assets constructed by the Company include direct costs, overheads and interest charges incurred during the construction period. Government investment grants are deducted from the cost of the related asset. Depreciation is calculated using the straight-line method over the expected economic life of the asset. Depreciation of special tooling is generally also based on the straight-line method. Gains and losses on the sale of property, plant and equipment are included in other business income. Costs related to repair and maintenance activities are expensed in the period in which they are incurred unless leading to an extension of the original lifetime or capacity. Plant and equipment under capital leases are initially recorded at the present value of minimum lease payments. These assets and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the asset.

### Asset retirement obligations

The Company applies SFAS No. 143 'Accounting for Asset Retirement Obligations' (SFAS 143) and FASB Interpretation No. 47 'Accounting for Conditional Asset Retirement Obligations,' Under the provisions of these pronouncements the Company recognizes the fair value of an asset retirement obligation in the period in which it is incurred, while an equal amount is capitalized as part of the carrying amount of the long-lived asset and subsequently depreciated over the life of the asset.

### Goodwill

The Company accounts for goodwill in accordance with the provisions of SFAS 141 and SFAS No. 142 'Goodwill and Other Intangible Assets', (SFAS 142). Accordingly, goodwill is not amortized but tested for impairment annually in the third quarter or whenever impairment indicators require so. During the predecessor period the annual goodwill impairment test was executed in the second quarter.

An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the carrying value of each reporting unit by assigning the assets and liabilities, including the goodwill and intangible assets, to those reporting units. Furthermore, the Company determines the fair value of each reporting unit and compares it to the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds the fair value of the reporting unit, the Company performs the second step of the impairment test. In the second step, the Company compares the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation upon a business combination in accordance with SFAS 141. The residual fair value after this allocation is the implied fair value of the reporting unit's goodwill. The Company generally determines the fair value of the reporting units based on discounted projected cash flows.

### Intangible assets

Intangible assets (other than goodwill) arising from acquisitions are amortized using the straight-line method over their estimated economic lives. Economic lives are evaluated every year. There are currently no intangible assets with indefinite lives. In-process research and development with no alternative use is written off immediately upon acquisition. Patents and trademarks acquired from third parties are capitalized at cost and amortized over their remaining lives.

Certain costs relating to the development and purchase of software for internal use are capitalized and subsequently amortized over the estimated useful life of the software in conformity with Statement of Position (SOP) 98-1, 'Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.'

### Impairment or disposal of intangible assets other than goodwill and tangible fixed assets

The Company accounts for intangible and tangible fixed assets in accordance with the provisions of SFAS No. 144, 'Accounting for the Impairment or Disposal of Long-Lived Assets'. This Statement requires that long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset with future undiscounted net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. The Company determines the fair value based on discounted projected cash flows. The review for impairment is carried out at the level where discrete cash flows occur that are largely independent of other cash flows. For the IC Manufacturing Operations (IMO) segment, the review of impairment of long-lived assets is carried out on a Company-wide basis as IMO is the shared manufacturing base for the other business units with, for this purpose, no discrete cash flows that are largely independent of other cash flows. Assets held for sale are reported at the lower of the carrying amount or fair value, less cost to sell.

### Research and development

Costs of research and development are expensed in the period in which they are incurred, in conformity with SFAS No. 2, 'Accounting for Research and Development Costs'.

### Advertising

Advertising costs are expensed when incurred.

### Provisions and accruals

The Company recognizes provisions for liabilities and probable losses that have been incurred as of the combined and consolidated balance sheet dates and for which the amount is uncertain but can be reasonably estimated.

Provisions of a long-term nature are stated at present value when the amount and timing of related cash payments are fixed or reliably determinable unless discounting is prohibited under US GAAP. Short-term provisions are stated at face value.

The Company applies the provisions of SOP 96-1, 'Environmental liabilities' and SFAS No. 5, 'Accounting for Contingencies' and accrues for losses associated with environmental obligations when such losses are probable and reasonably estimable. Additionally, in accordance with SOP 96-1, the Company accrues for certain costs such as compensation and benefits for employees directly involved in the remediation activities. Measurement of liabilities is based on current legal requirements and existing technology. Liabilities and expected insurance recoveries, if any, are recorded separately. The carrying amount of liabilities is regularly reviewed and adjusted for new facts or changes in law or technology.

## Restructuring

The Company applies SFAS No. 146, 'Accounting for Costs Associated with Exit or Disposal Activities' (SFAS 146).

The provision for restructuring relates to the estimated costs of initiated reorganizations that have been approved by the Board of Management, and which involve the realignment of certain parts of the industrial and commercial organization. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in restructuring provisions.

SFAS 146 requires that a liability be recognized for those costs only when the liability is incurred, i.e. when it meets the definition of a liability. SFAS 146 also establishes fair value as the objective for initial measurement of the liability.

Liabilities related to one-time employee termination benefits are recognized ratably over the future service period when those employees are required to render services to the Company, if that period exceeds 60 days or a longer legal notification period.

Employee termination benefits covered by a contract or under an ongoing benefit arrangement continue to be accounted for under SFAS No. 112, 'Employer's Accounting for Postemployment Benefits,' and are recognized when it is probable that the employees will be entitled to the benefits and the amounts can be reasonably estimated.

## Guarantees

The Company complies with FASB Interpretation No. 45, 'Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others' (FIN 45). In accordance with this Interpretation, the Company recognizes, at the inception of a guarantee that is within the scope of the recognition criteria of the Interpretation, a liability for the fair value of the obligation undertaken in issuing the guarantee.

### Debt and other liabilities

Debt and other liabilities, other than provisions, are stated at amortized cost. However, loans that are hedged under a fair value hedge are remeasured for the changes in the fair value that are attributable to the risk that is being hedged. Debt issue cost is not expensed immediately but are reported as deferred charges and subsequently amortized over the term of the debt using the effective interest rate method.

Currently, the Company does not have any financial instruments that are affected by SFAS No. 150 'Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity'.

## Revenue recognition

The Company's revenues are primarily derived from made-to-order sales to Original Equipment Manufacturers ("OEM's") and similar customers. Furthermore, the Company's revenues are derived from sales to distributors.

The Company applies the guidance in SEC Staff Accounting Bulletin Topic 13 "Revenue Recognition" and recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or the service has been provided, the sales price is fixed or determinable, and collection is reasonably assured, based on the terms and conditions of the sales contract. For made-to-order sales, these criteria are generally met at the time the product is shipped and delivered to the customer and title and risk have passed to the customer. Examples of delivery conditions typically meeting these criteria are 'Free on Board point of delivery' and 'Costs, Insurance Paid point of delivery'. Generally, the point of delivery is the customer's warehouse. Acceptance of the product by the customer is generally not contractually required, since, with made-to-order customers, design approval commences manufacturing and delivery without further acceptance protocols. Payment terms used are those that are customary in the particular geographic market. When management has established that all aforementioned conditions for revenue recognition have been met and no further post-shipment obligations exist revenue is recognized.

For sales to distributors, the same recognition principles apply and similar terms and conditions as for sales to other customers are applied. However, for some distributors contractual arrangements are in place, which allow these distributors to return products if certain conditions are met. These conditions generally relate to the time period during which return is allowed and reflect customary conditions in the particular geographic market. Other return conditions relate to circumstances arising at the end of a product cycle, when certain distributors are permitted to return products purchased during a pre-defined period after the Company has announced a product's pending discontinuance. Long notice periods associated with these announcements generally prevent significant amounts of product from being returned, however. Repurchase agreements with OEM's or distributors are not entered into by the Company.

For sales where return rights exist, the Company applies the guidance given in SFAS 48 "Recognition When Right of Return Exists." Based on historical data, management has determined that only a very small percentage of the sales to this type of distributors is actually returned. Currently the return percentage is less than 1%. In accordance with the requirements of SFAS 48, a pro rata portion of the sales to these distributors is not recognized but deferred until the return period has lapsed or the other return conditions no longer apply.

Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. Shipping and handling costs billed to customers are recognized as revenues. Expenses incurred for shipping and handling costs of internal movements of goods are recorded as cost of sales. Shipping and handling costs related to sales to third parties are reported as selling expenses.

A provision for product warranty is made at the time of revenue recognition and reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to the sold products. In cases where the warranty period is extended and the customer has the option to purchase such an extension, which is subsequently billed separately to the customer, revenue recognition occurs on a straight-line basis over the contract period.

Royalty income, which is generally earned based upon a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis. Government grants, other than those relating to purchases of assets, are recognized as income as qualified expenditures are made.

## Income taxes

Income taxes in the consolidated financial statements are accounted for using the asset and liability method. Income tax is recognized in the statement of operations except to the extent that it relates to an item recognized directly within business' or shareholder's equity, including other comprehensive income (loss), in which case the related tax effect is also recognized there.

Current-year deferred taxes related to prior-year equity items, which arise from changes in tax rates or tax laws are included in income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the combined and consolidated balance sheet dates, and any adjustment to tax payable in respect of previous years. Income tax payable includes amounts payable to tax authorities and intercompany payable with Philips. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts. Measurement of deferred tax assets and liabilities is based upon the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets, including assets arising from loss carryforwards, are recognized if it is more likely than not that the asset will be realized. Deferred tax assets and liabilities are not discounted. Deferred tax liabilities for withholding taxes are recognized for subsidiaries in situations where the income is to be paid out as dividends in the foreseeable future, and for undistributed earnings of minority shareholdings.

Changes in tax rates are reflected in the period that includes the enactment date.

*Predecessor*

The Company's income taxes as presented in the combined financial statements are calculated on a separate tax return basis, although the Company was included in the consolidated tax return of Philips. Philips manages its tax position for the benefit of its entire portfolio of businesses, and its tax strategies are not necessary reflective of the tax strategies that the Company would have followed as a stand-alone Company.

## Benefit accounting

The Company accounts for the cost of pension plans and postretirement benefits other than pensions in accordance with SFAS No. 87, 'Employers' Accounting for Pensions', and SFAS No. 106, 'Postretirement Benefits other than Pensions', respectively.

The Company employees participate in pension and other postretirement benefit plans that Philips has established in many countries. The costs of pension and other postretirement benefits and related assets and liabilities with respect to the Company employees participating in these plans have been allocated to the Company based upon actuarial computations.

Obligations for contributions to defined-contribution pension plans are recognized as an expense in the statement of operations as incurred.

*Predecessor*
The Company has accounted for its participation in Philips sponsored pension plans in which the Company and other Philips businesses participate as multi-employer plans. Related assets and liabilities are therefore not included in the Company's balance sheets. For pension and other postretirement benefit plans in which only the Company employees participate (the Company dedicated plans), the related costs, assets and liabilities have been included in the combined and consolidated balance sheets.

The costs of pension and other postretirement benefits with respect to the Company employees participating in the Philips plans have been allocated to the Company based upon actuarial computations, except for certain less significant plans, in which case a proportional allocation based upon compensation or headcount has been used.

### Share-based compensation

*Predecessor*
In 2003, the Company adopted the fair value recognition provisions of SFAS No. 123, 'Accounting for Stock-Based Compensation' (SFAS 123), as amended by SFAS No. 148, 'Accounting for Stock-Based Compensation – Transition and Disclosure', prospectively for all employee awards granted, modified or settled after January 1, 2003. Effective January 1, 2006, the Company adopted SFAS No. 123 (Revised 2004) (SFAS 123(R)), using the modified prospective method for the transition. Since the Company already adopted the fair value recognition provision of SFAS 123, the effects of the adoption of the revised standard on the Company was not material. Under the provisions of SFAS 123(R), the Company recognizes the estimated fair value of equity instruments granted to employees as compensation expense over the vesting period on a straight-line basis. These employee awards were previously granted by Philips to its employees and have been allocated to the Company for the purpose of the predecessor combined financial statements.

For awards granted to employees prior to 2003, the Company continued to account for share-based compensation using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, 'Accounting for Stock Issued to Employees'. These employee awards were previously granted by Philips to its employees and have been subsequently allocated to the Company.

The following table illustrates the effect on net income (loss) in the combined statements of operation as if the Company had applied the fair value recognition provisions for all outstanding and unvested awards in each period:

| | For the years ended December 31, | |
|---|---|---|
| | 2004 | 2005 |
| Net income (loss) | | |
| As reported | 14 | (101) |
| Add: Share-based compensation expense included in reported net income (loss), net of related tax | 15 | 16 |
| Deduct: Share-based compensation expense determined using the fair value method, net of related tax | (30) | (18) |
| Pro forma | (1) | (103) |

There was no impact for 2006 as all awards previously granted under APB Opinion No. 25 were fully vested as of December 31, 2005 (three-year vesting term, and the Company adopted SFAS 123 effective January 1, 2003).

*Successor*
Immediately before the date of acquisition of our Company by KASLION, Philips announced all outstanding unvested stock options and restricted share rights related to employees of the semiconductor businesses of Philips would become fully vested and exercisable on October 16, 2006, which was recorded as part of the purchase allocation. For the successor period there is no share-based plan in place for employees and, as such, no new share-based compensation arrangements were granted to employees in the period from September 29, 2006 through December 31, 2006.

## Cash flow statements

Cash flow statements have been prepared using the indirect method in accordance with the requirements of SFAS No. 95, 'Statement of Cash flows', as amended by SFAS No. 104, 'Statement of Cash Flows - Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions'. Cash flows in foreign currencies have been translated into euros using the weighted average rates of exchange for the periods involved.

Cash flows from derivative instruments that are accounted for as fair value hedges or cash flow hedges are classified in the same category as the cash flows from the hedged items. Cash flows from derivative instruments for which hedge accounting has been discontinued are classified consistent with the nature of the instrument as from the date of discontinuance.

## Concentration of risk

The Company's sales are for a large part dependent on a limited number of customers, none of which individually exceeds 10% of total sales. Furthermore, the Company is using outside suppliers of foundries for a portion of its manufacturing capacity. For certain equipment and materials the Company relies on a single source of supply.

## New accounting standards

The FASB issued several pronouncements, of which the following are to various degrees of relevance to the Company.

FASB Staff Position (FSP) SFAS 123(R)-4 Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event.

This FSP was posted on February 3, 2006 and amends paragraph 32 of SFAS 123 (revised 2004) Share-based Payment. The FSP requires share options and restricted shares that have contingent cash settlement features that are outside the control of the employee, such as a change in control or the death or disability of an employee, to be accounted for as liabilities rather than equity if the contingent event is probable of occurring. The share-based compensation plans of Philips that the Company's employees participated in do not contain contingent cash settlement features. Cash settlement can only occur upon initiative of Philips and with consent of the employee. Therefore it is concluded that this FSP is not applicable for the Company. FSP FIN 46(R)-6 Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R).

This FSP addresses how the variability to be considered for variable interest entities should be determined. The FSP becomes effective January 1, 2007. The Company believes that application of this FSP will not have any effect.

In July 2006 the FASB issued FASB Interpretation No. 48 'Accounting for Uncertainty in Income Taxes', (FIN 48). FIN 48 establishes the threshold for recognizing the benefits of tax-return positions in the combined and consolidated financial statements as 'more-likely-than-not' to be sustained by the taxing authority, and prescribes a measurement methodology for those positions meeting the recognition threshold. FIN 48 is effective for the fiscal years beginning after December 15, 2006. The Company is currently evaluating the effect that the adoption of FIN 48 will have on the Company's financial position and result of operations.

In September 2006, the FASB issued FASB Statement No. 157 "Fair value measurements", which sets out a framework for measuring fair values. It applies only to fair-value measurements that are already required or permitted by other accounting pronouncements. The Statement will become effective prospectively for the Company from 2008 going forward. In the limited situations in which the Statement requires retrospective application this is expected not to be applicable for the Company.

In September 2006, the FASB issued FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans" ("FASB 158"), which requires that we recognize on our balance sheet the over-funded or under-funded status of our defined benefit and post retirement plans as an asset or liability. For all of our defined pension benefit plans, the measurement date on which we determine the funded status is December 31.

FASB 158 requires that we recognize as a component of other comprehensive income the gains or losses and prior service costs and credits that arise during the year but are not recognized as a component of net periodic benefit cost. FASB 158 also requires that we disclose additional information regarding certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service credits, and transition assets or obligations. Since we have not issued equity securities that trade in a public market, we are not required to adopt the provisions of FASB 158 until our fiscal year ending December 31, 2007. The impact of adopting FASB 158 will be dependent upon the fair value of plan assets and the projected benefit obligations determined as of December 31, 2007.

December 21, 2006 FASB Staff position No. EITF 00-19-2 "Accounting for Registration Payment Arrangements" was posted. This FSP requires companies that agree to register securities recognizing a liability separate from the related securities if a payment to investors for failing to fulfill the agreement is probable and its amount can be reasonably estimated. Because the Company has agreed to register its outstanding Notes within 450 days from October 12, 2006 or otherwise incur higher interest expense on the Notes, this FSP is applicable from 2007 onwards. However, since the Company expects to register the Notes during 2007, it is not deemed probable that any higher interest expense will be incurred.

## 4 Information by Segment and Main Countries

The Company is structured in four market-oriented business units: Mobile & Personal, MultiMarket Semiconductors, Home and Automotive & Identification.

- Mobile & Personal delivers full systems solutions for cellular phones and personal entertainment devices.

- Home is a leading supplier of systems and components for the TV, PC TV and direct memory access segments of the consumer semiconductors market.

- Automotive & Identification has leading positions in car audio/radio, in-vehicle networking (IVN), car access and immobilization, tire pressure monitoring and magnetic sensors; Identification has leading positions in the radio frequency identification (RFID), near field communication (NFC) and eGovernment applications markets.

- MultiMarket Semiconductors provides a broad range of standard products (e.g. Bipolar, Power Discretes, Transistors & Diodes and Logic) and application specific standard products (e.g. Integrated Discretes, Interface Products and Microcontrollers).

The Company operates a shared manufacturing base, which is grouped in IC Manufacturing Operations, with the exception of manufacturing assets dedicated to MultiMarket Semiconductors products, which are reported as part of this segment.

Corporate and Other includes certain research and development activities, IP licensing, Emerging Products and special items not directly allocated to Business Units and/or IC Manufacturing Operations.

NXP Software (formerly Philips Software) included in Corporate and Other, specializes in innovative multimedia, security and connectivity solutions for manufacturers of mobile and portable equipment.

## Segments

| | sales | research and development expenses | income (loss) from operations | income (loss) from operations as a % of sales | results relating to unconsolidated companies |
|---|---|---|---|---|---|
| SUCCESSOR | | | | | |
| **For the period September 29, 2006 through December 31, 2006** | | | | | |
| Mobile & Personal | **396** | **91** | **(135)** | **(34.1)** | **-** |
| Home | **212** | **50** | **(164)** | **(77.4)** | **-** |
| Automotive & Identification | **210** | **35** | **(256)** | **(121.9)** | **-** |
| MultiMarket Semiconductors | **328** | **25** | **(79)** | **(24.1)** | **-** |
| IC Manufacturing Operations (*) | **28** | **11** | **(71)** | **-** [1] | **-** |
| Corporate and Other | **16** | **46** | **(74)** | **-** [1] | **(2)** |
| | **1,190** | **258** | **(779)** | **(65.5)** | **(2)** |
| PREDECESSOR | | | | | |
| **For the period January 1, 2006 through September 28, 2006** | | | | | |
| Mobile & Personal | 1,172 | 280 | 23 | 2.0 | - |
| Home | 730 | 146 | (37) | (5.1) | - |
| Automotive & Identification | 662 | 92 | 151 | 22.8 | - |
| MultiMarket Semiconductors | 1,017 | 67 | 203 | 20.0 | - |
| IC Manufacturing Operations (*) | 140 | 65 | 7 | - [1] | 4 |
| Corporate and Other | 49 | 87 | (208) | - [1] | (1) |
| | 3,770 | 737 | 139 | 3.7 | 3 |
| **For the year ended December 31, 2005** | | | | | |
| Mobile & Personal | 1,618 | 367 | 72 | 4.4 | - |
| Home | 1,002 | 293 | (85) | (8.5) | - |
| Automotive & Identification | 719 | 111 | 168 | 23.4 | - |
| MultiMarket Semiconductors | 1,238 | 101 | 139 | 11.2 | - |
| IC Manufacturing Operations (*) | 146 | 67 | 32 | - [1] | (3) |
| Corporate and Other | 43 | 89 | (224) | - [1] | (2) |
| | 4,766 | 1,028 | 102 | 2.1 | (5) |
| **For the year ended December 31, 2004** | | | | | |
| Mobile & Personal | 1,525 | 327 | 90 | 5.9 | - |
| Home | 1,060 | 305 | (30) | (2.8) | - |
| Automotive & Identification | 706 | 94 | 159 | 22.5 | - |
| MultiMarket Semiconductors | 1,268 | 102 | 139 | 11.0 | - |
| IC Manufacturing Operations (*) | 178 | 51 | (19) | - [1] | 6 |
| Corporate and Other | 86 | 100 | (105) | - [1] | 6 |
| | 4,823 | 979 | 234 | 4.9 | 12 |

(*) For the period September 29, 2006 through December 31, 2006, IC Manufacturing Operations supplied EUR 449 million (for the period January 1, 2006 through September 28, 2006: EUR 1,599 million, December 31, 2005: EUR 2,138 million, December 31, 2004: EUR 1,950 million) to other segments, which have been eliminated in the above presentation.

[1] Not meaningful

## Segments

| | inventories [1] | property, plant and equipment, net | gross capital expenditures | depreciation property, plant and equipment |
|---|---|---|---|---|
| SUCCESSOR | | | | |
| **For the period September 29, 2006 through December 31, 2006** | | | | |
| Mobile & Personal | **156** | **77** | **4** | **7** |
| Home | **84** | **49** | **2** | **3** |
| Automotive & Identification | **73** | **24** | **1** | **1** |
| MultiMarket Semiconductors | **166** | **300** | **14** | **26** |
| IC Manufacturing Operations | **167** | **1,377** | **65** | **106** |
| Corporate and Other | **-** | **457** | **25** | **28** |
| | **646** | **2,284** | **111** | **171** |
| PREDECESSOR | | | | |
| **For the period January 1, 2006 through September 28, 2006** | | | | |
| Mobile & personal | 175 | 47 | 19 | 12 |
| Home | 105 | 35 | 6 | 7 |
| Automotive & Identification | 81 | 15 | 10 | 2 |
| MultiMarket Semiconductors | 162 | 279 | 52 | 67 |
| IC manufacturing Operations | 188 | 1,448 | 234 | 301 |
| Corporate and Other | (1) | 145 | 144 | 63 |
| | 710 | 1,969 | 465 | 452 |
| **For the year ended December 31, 2005** | | | | |
| Mobile & Personal | 186 | 46 | 25 | 23 |
| Home | 94 | 47 | 12 | 12 |
| Automotive & Identification | 71 | 12 | 4 | 4 |
| MultiMarket Semiconductors | 167 | 299 | 34 | 108 |
| IC Manufacturing Operations | 217 | 1,524 | 258 | 573 |
| Corporate and Other | (39) | 128 | 37 | 29 |
| | 696 | 2,056 | 370 | 749 |
| **For the year ended December 31, 2004** | | | | |
| Mobile & Personal | 145 | 56 | 16 | 29 |
| Home | 127 | 50 | 8 | 13 |
| Automotive & Identification | 70 | 11 | 4 | 3 |
| MultiMarket Semiconductors | 166 | 348 | 65 | 108 |
| IC Manufacturing Operations | 149 | 1,747 | 489 | 600 |
| Corporate and Other | (6) | 81 | 59 | 11 |
| | 651 | 2,293 | 641 | 764 |

1) Inventory "Corporate and Other" includes the central value adjustment, i.e. the central intercompany profit elimination from inventories.

## Goodwill assigned to segments

| | carrying value at September 29, 2006 | acquisitions | impairment | translation differences and other changes | carrying value at December 31, 2006 |
|---|---|---|---|---|---|
| SUCCESSOR | | | | | |
| **For the period September 29, 2006 through December 31, 2006** | | | | | |
| Mobile & Personal | **356** | **-** | **-** | **-** | **356** |
| Home | **274** | **-** | **-** | **-** | **274** |
| Automotive & Identification | **723** | **-** | **-** | **-** | **723** |
| MultiMarket Semiconductors | **442** | **-** | **-** | **-** | **442** |
| IC Manufacturing Operations | **181** | **27** | **-** | **-** | **208** |
| Corporate and Other | **29** | **-** | **-** | **-** | **29** |
| | **2,005** | **27** | **-** | **-** | **2,032** |

| | carrying value at January 1, 2006 | acquisitions | impairment | translation differences and other changes | carrying value at September 28, 2006 |
|---|---|---|---|---|---|
| PREDECESSOR | | | | | |
| **For the period January 1, 2006 through September 28, 2006** | | | | | |
| Mobile & Personal | 30 | - | - | (2) | 28 |
| Home | 28 | - | - | (2) | 26 |
| Automotive & Identification | 69 | - | - | (4) | 65 |
| MultiMarket Semiconductors | 72 | - | - | (4) | 68 |
| IC Manufacturing Operations | 14 | - | - | (1) | 13 |
| Corporate and Other | - | - | - | - | - |
| | 213 | - | - | (13) | 200 |

## Main countries

| | Total sales |
|---|---|
| SUCCESSOR | |
| **For the period September 29, 2006 through December 31, 2006** | |
| China | **254** |
| Netherlands | **181** |
| Taiwan | **100** |
| United States | **102** |
| Singapore | **150** |
| Germany | **70** |
| South Korea | **11** |
| Other countries | **322** |
| | **1,190** |

| | sales to third parties | sales to Philips companies | total sales [1] |
|---|---|---|---|
| PREDECESSOR | | | |
| **For the period January 1, 2006 through September 28, 2006** | | | |
| China | 831 | 22 | 853 |
| Netherlands | 591 | 15 | 606 |
| Taiwan | 270 | - | 270 |
| United States | 367 | 13 | 380 |
| Singapore | 433 | 5 | 438 |
| Germany | 196 | - | 196 |
| South Korea | 312 | - | 312 |
| Other countries | 702 | 13 | 715 |
| | 3,702 | 68 | 3,770 |
| **For the year ended December 31, 2005** | | | |
| China | 1,187 | 89 | 1,276 |
| Netherlands | 24 | 17 | 41 |
| Taiwan | 510 | 3 | 513 |
| United States | 299 | 17 | 316 |
| Singapore | 222 | 4 | 226 |
| Germany | 323 | 2 | 325 |
| South Korea | 585 | - | 585 |
| Other countries | 1,465 | 19 | 1,484 |
| | 4,615 | 151 | 4,766 |
| **For the year ended December 31, 2004** | | | |
| China | 1,065 | 118 | 1,183 |
| Netherlands | 56 | 19 | 75 |
| Taiwan | 496 | 5 | 501 |
| United States | 365 | 24 | 389 |
| Singapore | 309 | 19 | 328 |
| Germany | 297 | 18 | 315 |
| South Korea | 454 | - | 454 |
| Other countries | 1,567 | 11 | 1,578 |
| | 4,609 | 214 | 4,823 |

1) In 2004 and 2005, the allocation is based on customer location.
From September 29, 2006 onwards, sales to Philips companies amounting to Euro 18 million are included in sales to third parties.

## Main countries

| | property, plant and equipment, net | gross capital expenditures | depreciation property, plant and equipment |
|---|---|---|---|
| SUCCESSOR | | | |
| **For the period September 29, 2006 through December 31, 2006** | | | |
| China | **122** | **6** | **12** |
| Netherlands | **690** | **16** | **45** |
| Taiwan | **110** | **2** | **9** |
| United States | **67** | **6** | **5** |
| Singapore | **306** | **20** | **32** |
| Germany | **236** | **13** | **15** |
| South Korea | **1** | **-** | **-** |
| Other countries | **752** | **48** | **53** |
| | **2,284** | **111** | **171** |
| PREDECESSOR | | | |
| **For the period January 1, 2006 through September 28, 2006** | | | |
| China | 133 | 38 | 30 |
| Netherlands | 299 | 33 | 70 |
| Taiwan | 121 | 19 | 30 |
| United States | 68 | 12 | 28 |
| Singapore | 339 | 43 | 109 |
| Germany | 242 | 62 | 50 |
| South Korea | 1 | - | - |
| Other countries | 766 | 258 | 135 |
| | 1,969 | 465 | 452 |
| **For the year ended December 31, 2005** | | | |
| China | 132 | 31 | 42 |
| Netherlands | 336 | 87 | 127 |
| Taiwan | 144 | 28 | 53 |
| United States | 97 | 19 | 51 |
| Singapore | 434 | 42 | 183 |
| Germany | 234 | 41 | 92 |
| South Korea | - | - | - |
| Other countries | 679 | 122 | 201 |
| | 2,056 | 370 | 749 |
| **For the year ended December 31, 2004** | | | |
| China | 126 | 59 | 32 |
| Netherlands | 420 | 140 | 159 |
| Taiwan | 149 | 62 | 62 |
| United States | 130 | 13 | 61 |
| Singapore | 509 | 215 | 156 |
| Germany | 285 | 55 | 84 |
| South Korea | - | - | - |
| Other countries | 674 | 97 | 210 |
| | 2,293 | 641 | 764 |

## 5 Related-party transactions

The Company entered into related-party transactions with the following companies:

1. Philips, which was the Company's parent during the predecessor periods and continued to hold an indirect 19.9% beneficial interest during the successor period.
2. Taiwan Semiconductor Manufacturing Company (TSMC) is a related party during the predecessor period as a result of Philips' interest in TSMC.
3. Advanced Semiconductor Manufacturing Corporation (ASMC) is an affiliate of the Company (see note 11).

NXP and Philips will have continuing relationships through shared research and development activities and through license agreements. The existing global service agreements for – amongst others – payroll, network and purchase facilities cover a period of approximately one year. Additionally, through the purchase of component products, namely semiconductor products for the consumer electronic sector, NXP and Philips will have a continuing relationship for the foreseeable future.

The following table presents the amounts related to revenues and expenses incurred in transactions with these related parties:

| | PREDECESSOR | | | **SUCCESSOR** |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, | **For the period September 29, 2006 – December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Sales | 395 | 294 | 160 | **46** |
| Purchase of goods and services | 420 | 325 | 170 | **54** |
| General corporate expenses | 82 | 81 | 62 | **-** |
| Basic research | 14 | 13 | 14 | **-** |
| Interest expense to Philips companies, net | 66 | 42 | 6 | **-** |

The following table presents the amounts related to account receivable and payable balances with Philips:

| | Predecessor December 31, 2005 | **Successor December 31, 2006** |
|---|---|---|
| Receivables | 34 | **49** |
| Payables | 55 | **43** |
| Loans with Philips companies | 1,112 | **-** |

*Predecessor*

### Costs of services and corporate functions

During the predecessor periods the Company participated in a variety of corporate-wide programs administered by Philips in areas such as cash management, insurance, employee benefits, information technology, intellectual property, and customs.

Furthermore, the Company utilized various Philips shared services organizations for services such as:

- Human Resource services such as payroll processing, benefits administration, recruitment and training
- Accounting services
- Information technology such as the cost of hardware, network and standard software applications
- Purchasing of non-product related items
- Real Estate services

The costs of these services have been charged or allocated to the Company based on service level agreements and other contracts that include agreements on charges against actual costs. Please refer to notes 22, 23 and 30 for a discussion of the costs of pension benefits, other postretirement benefits and share-based compensation.

*Successor*
In December 2006, selected members of our management purchased approximately 9.5 million depository receipts issued by the Stichting Management Co-Investment NXP, each of these receipts representing an economic interest in a common share of KASLION. These depository receipts have been purchased at fair market value and in the aggregate represent a beneficial interest in KASLION of 0.22%.

### General corporate expenses and Basic Research

The financial statements for the predecessor periods also include expense allocations for certain corporate functions, historically provided by Philips but not charged to the semiconductors segment, such as management oversight, accounting, treasury, tax, legal, brand management and human resources, as well as an allocation of the costs of basic research performed by Philips. A proportional cost allocation method based upon sales has been used to estimate the amounts of these allocations.

The Company considers the allocation of the costs of the aforementioned services and functions to be reasonable. However, these amounts may not be indicative of the costs necessary for the Company to operate as a stand-alone entity.

### Interest expense

The amount of net interest expense charged by Philips included in the combined statements of operations for 2004, 2005, and January 1, 2006 through September 28, 2006 amounted to EUR 66 million, EUR 42 million, and EUR 6 million, respectively.

### Loans with Philips companies

At the end of December 31, 2005, the Company had outstanding loans with Philips companies aggregating EUR 1,112 million, of which EUR 502 million was classified as non-current. As a result of the Separation, the Company repaid all outstanding balances as of September 28, 2006.

### Cash management and financing

During the predecessor periods, the Company participated in Philips' worldwide cash management system under which the Company maintains bank accounts in specific banks as directed by Philips. Such accounts were generally zero balanced, where possible, to the Philips global pool, allowing cash to be managed and centralized by Philips.

The transfer of funds in and between the countries is accounted for via intercompany accounts. The balance of these intercompany accounts has been presented in the caption Philips' net investment in the Company, which is presented as a part of business' equity. Interest income and expense are generally not recorded on these domestic intercompany balances. Where pooling of cash balances was not possible, longer term cash surpluses were generally placed on deposit with Philips until dividends were distributed to Philips. Philips also maintained an in-house banking arrangement that provided facilities for Philips entities to obtain funds for local short term funding requirements. Longer term and structural financing was provided to Philips legal entities either through specific intercompany loans with Philips or through third party financing. Philips did not allocate interest to specific segments or businesses. The combined statements of operations include intercompany interest income and expense that has been recorded by legal entities that include only the Company's businesses. Interest income and expense of shared legal entities of the Company and other Philips divisions have not been included in the combined statements of operations.

Cash and cash equivalents, external debt, intercompany loans, and related interest income and expense have been included in the Company's financial statements for the predecessor periods to the extent such amounts were actually held or incurred by the legal entities that are part of the Company.

## 6 Acquisitions and divestments

*Predecessor*

In 2005, additional shares in SSMC were acquired for a cash payment of EUR 22 million. Goodwill of EUR 14 million was recognized as a result of this transaction. The shareholding in SSMC increased from 48% to 50.5%.

In 2006 and 2005 there were no material divestments. In 2004, the 22% stake in Computer Access Technologies Corp. (USA) was sold for EUR 16 million, of which EUR 9 million was collected in 2004 and EUR 7 million in 2005.

*Successor*

In November 2006, the option to purchase additional outstanding stock of the Singapore-based wafer fabrication firm Systems on Silicon Manufacturing Company (SSMC) was fully exercised. An incremental 10.7% SSMC shares were acquired from the Economic Development Board (EDB), increasing the Company's equity interest to 61.2%, at cost of EUR 90 million paid in cash.

The total purchase price was allocated to property, plant and equipment (EUR 7 million), goodwill (EUR 27 million), other intangibles (EUR 11 million) and, as a consequence, a reduction in minority interests (EUR 45 million). Other intangibles fully consist of core technology.

There were no major divestments.

# 7 Income from operations

For information related to sales and income from operations on a geographical and business basis, see note 4.

## Sales composition

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, | **For the period September 29, 2006 – December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Goods | 4,752 | 4,737 | 3,753 | **1,184** |
| Licenses | 71 | 29 | 17 | **6** |
| | 4,823 | 4,766 | 3,770 | **1,190** |

## Salaries and wages

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, | **For the period September 29, 2006 – December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Salaries and wages | 1,225 | 1,228 | 958 | **337** |
| Pension and other postemployment costs | 83 | 74 | 70 | **26** |
| Other social security and similar charges: | | | | |
| - Required by law | 154 | 149 | 136 | **45** |
| - Voluntary | 11 | 8 | 2 | **1** |
| | 1,473 | 1,459 | 1,166 | **409** |

Included in salaries and wages for the period September 29, 2006 through December 31, 2006 is nil (January 1, 2006 through September 28, 2006: EUR 14 million, 2005: EUR 6 million, 2004: EUR 36 million) relating to restructuring charges. Pension and postemployment costs are comprised of the costs of pension benefits, other postretirement benefits, and postemployment benefits, including obligatory severance.

For the period September 29, 2006 through December 31, 2006, remuneration and pension charges relating to the members of the board of management amounted to EUR 700,000. During this period, no additional amount was awarded in the form of other compensation. When pension rights are granted to members of the board of management, necessary payments (if insured) and all necessary provisions are made in accordance with the applicable accounting principles.
The members of our Supervisory Board, other than Sir Peter Bonfield, do not receive any cash compensation for their service on our Supervisory Board.

Refer to note 21, 22 and 23 to the financial statements for further information regarding these benefits.

### Depreciation and amortization

Depreciation of property, plant and equipment and amortization of intangibles are as follows:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, 2004 | 2005 | For the period January 1, 2006 – September 28, 2006 | **For the period September 29, 2006 – December 31, 2006** |
| Depreciation of property, plant and equipment | 764 | 749 | 452 | **171** |
| Amortization of internal use software | 51 | 35 | 10 | **6** |
| Amortization of other intangible assets | 34 | 34 | 9 | **119** |
| Write-off of in-process research and development | - | - | - | **515** |
| | 849 | 818 | 471 | **811** |

Depreciation of property, plant and equipment for the period September 29, 2006 through December 31, 2006 includes an additional write-off in connection with the retirement of property, plant and equipment amounting to EUR 3 million (January 1, 2006 through September 28, 2006: EUR 1 million, 2005: EUR 5 million, 2004: EUR 15 million).

No impairment charges relating to depreciation of property, plant and equipment were recorded for the period September 29, 2006 through December 31, 2006 (January 1, 2006 through September 28, 2006: nil, 2005: EUR 5 million, 2004: EUR 8 million). Depreciation of property, plant and equipment and amortization of software are primarily included in cost of sales.

### Rent

Rent expenses amounted to EUR 20 million for the period September 29, 2006 through December 31, 2006 (January 1, 2006 through September 28, 2006: EUR 49 million, 2005: EUR 62 million, 2004: EUR 53 million).

### Selling expenses

Selling expenses incurred for the period September 29, 2006 through December 31, 2006 totaled EUR 88 million (January 1, 2006 through September 28, 2006: EUR 275 million, 2005: EUR 304 million, 2004: EUR 297 million), of which nil (January 1, 2006 through September 28, 2006: EUR 2 million, 2005: EUR 8 million, 2004: EUR 4 million) was allocated from Philips.

The selling expenses mainly relate to the cost of the sales and marketing organization. This mainly consists of account management, marketing, first and second line support, and order desk.

### General and administrative expenses

General and administrative expenses include the costs related to management and staff departments in the corporate center, business units and business lines, amounting to EUR 194 million for the period September 29, 2006 through December 31, 2006 (January 1, 2006 through September 28, 2006: EUR 306 million, 2005: EUR 435 million, 2004: EUR 437 million), of which nil (January 1, 2006 through September 28, 2006: EUR 63 million, 2005: EUR 83 million, 2004: EUR 83 million) was allocated from Philips.

## Research and development expenses

Expenditures for research and development activities amounted to EUR 258 million for the period September 29, 2006 through December 31, 2006 (January 1, 2006 through September 28, 2006: EUR 737 million, 2005: EUR 1,028 million, 2004: EUR 979 million), of which nil (January 1, 2006 through September 28, 2006: EUR 14 million, 2005: EUR 13 million, 2004: EUR 14 million) was allocated from Philips.

For information related to research and development expenses on a segment basis, refer to note 4.

## Write-off of acquired in-process research and development

As part of the purchase price allocation EUR 515 million was identified as in-process research and development relating to incomplete projects for which no alternative use could be determined. The full amount has been written-off immediately and charged to the statement of operations for the period September 29, 2006 through December 31, 2006 (refer to note 2 regarding purchase accounting).

## Other income

Other income consists of the following:

| | PREDECESSOR | | | **SUCCESSOR** |
|---|---|---|---|---|
| | For the years ended December 31, 2004 | 2005 | For the period January 1, 2006 – September 28, 2006 | **For the period September 29, 2006 – December 31, 2006** |
| Results on disposal of properties | 11 | 17 | 7 | **4** |
| Remaining income | 68 | 19 | 11 | **(1)** |
| | 79 | 36 | 18 | **3** |

The result on disposal of fixed assets for the period September 29, 2006 through December 31, 2006 represents the gain on the sale of various properties. For the period January 1, 2006 through September 28, 2006 it also related to various gains on sale of properties, of which the most significant was the sale of property in Albuquerque. In 2005 it mainly related to the sale of property in San José, US and Vienna. In 2004, it was mainly related to the sale of property in San José, US.

For the period September 29, 2006 through December 31, 2006, remaining income consists of various smaller items. For the period January 1, 2006 through September 28, 2006 it also consists of various smaller items. In 2005, remaining income consists of various items, the most significant being the partial recovery of a customer claim from one of our suppliers. In 2004, the most significant item related to insurance recoveries for a fire in one of the Company's factories amounting to EUR 63 million.

## 8 Restructuring and impairment charges

The components of restructuring and impairment charges recognized in the predecessor periods 2004, 2005, January 1, 2006 through September 28, 2006, and successor period September 29, 2006 through December 31, 2006 are as follows:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, 2004 | 2005 | For the period January 1, 2006 – September 28, 2006 | **For the period September 29, 2006 – December 31, 2006** |
| Personnel lay-off costs | 40 | 10 | 19 | **5** |
| Write-down of assets | - | 2 | 3 | **-** |
| Other restructuring costs | 1 | - | - | **-** |
| Release of excess provisions/accruals | (9) | (4) | (5) | **(1)** |
| Net restructuring and impairment | 32 | 8 | 17 | **4** |

The restructuring and impairment charges are included in the following line items in the statement of operations:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, 2004 | 2005 | For the period January 1, 2006 – September 28, 2006 | **For the period September 29, 2006 – December 31, 2006** |
| Cost of sales | 32 | 2 | 3 | **5** |
| Research & development expenses | - | 6 | 5 | **-** |
| Selling expenses | - | - | 9 | **(1)** |
| Net restructuring and impairment charges | 32 | 8 | 17 | **4** |

In the predecessor periods, the Company has executed restructuring programs to reduce excess capacity, increase operational efficiency and implement an asset-light flexible manufacturing strategy. In 2004 and 2005, the charges related to a further reduction of excess capacity, overhead, and research and development costs in Europe and included the lay-off of 700 workers and 225 workers respectively. In the period January 1, 2006 through September 28, 2006 the charge is mainly related to the restructuring of the back-office of the sales organization (EUR 9 million), the increase of the operational efficiency in the manufacturing organization (EUR 3 million) and reorganization of development sites in Europe (EUR 5 million). In the successor period September 29, 2006 through December 31, 2006 it related to releases from our sales organizations' restructuring and our activities in Stadskanaal.

The balance of restructuring liabilities as of December 31, 2006 amounted to EUR 12 million, which is presented in the balance sheet under accrued liabilities (EUR 8 million) and other non-current liabilities (EUR 4 million). At December 31, 2005, EUR 18 million is presented under accrued liabilities and EUR 2 million under other non-current liabilities.

*Predecessor*

The following tables present the changes in the position of restructuring liabilities and provisions from December 31, 2003 through September 28, 2006:

| | balance January 1, 2006 | additions | utilized | released [1] | other changes [2] | balance September 28, 2006 |
|---|---|---|---|---|---|---|
| Personnel costs | 20 | 19 | (14) | (5) | - | 20 |
| Write-down of assets | - | 3 | (3) | - | - | - |
| Other costs | - | - | - | - | - | - |
| | 20 | 22 | (17) | (5) | - | 20 |

| | balance January 1, 2005 | additions | utilized | released [1] | other changes [2] | balance December 31, 2005 |
|---|---|---|---|---|---|---|
| Personnel costs | 39 | 10 | (25) | (4) | - | 20 |
| Write-down of assets | - | 2 | (2) | - | - | - |
| Other costs | 2 | - | (2) | - | - | - |
| | 41 | 12 | (29) | (4) | - | 20 |

| | balance January 1, 2004 | additions | utilized | released [1] | other changes [2] | balance December 31, 2004 |
|---|---|---|---|---|---|---|
| Personnel costs | 41 | 40 | (39) | (4) | 1 | 39 |
| Write-down of assets | - | - | - | - | - | - |
| Other costs | 25 | 1 | (19) | (5) | - | 2 |
| | 66 | 41 | (58) | (9) | 1 | 41 |

*Successor*

The following table presents the changes in the position of restructuring liabilities and provisions from September 29, 2006 through December 31, 2006:

| | balance September 29, 2006 | additions | utilized | released [1] | other changes [2] | balance December 31, 2006 |
|---|---|---|---|---|---|---|
| Personnel costs | **20** | **5** | **(12)** | **(1)** | **-** | **12** |
| Write-down of assets | **-** | **-** | **-** | **-** | **-** | **-** |
| Other costs | **-** | **-** | **-** | **-** | **-** | **-** |
| | **20** | **5** | **(12)** | **(1)** | **-** | **12** |

(1) The releases of surplus in 2006, 2005 and 2004 were primarily attributable to reduction in severance payment due to an internal transfer of employees who were originally expected to be laid off to other positions in the Company. In 2004, the release was partly attributable to the proceeds from the sale of tools and equipment, which was originally not foreseen in the plan

(2) Other changes primarily related to translation differences

## 9 Financial income and expenses

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, | **For the period September 29, 2006 – December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Interest income | 1 | 2 | 3 | **12** |
| Interest expense | (23) | (21) | (16) | **(91)** |
| Interest expense Philips, net | (66) | (42) | (6) | **-** |
| Total interest expense, net | (88) | (61) | (19) | **(79)** |
| Foreign exchange results | - | 2 | - | **48** |
| Miscellaneous financing costs/income, net | (5) | (4) | (3) | **(42)** |
| Total other income and expense | (5) | (2) | (3) | **6** |
| Total | (93) | (63) | (22) | **(73)** |

*Predecessor*

Interest expense, net decreased to EUR 19 million (2005: EUR 61 million; 2004 EUR 88 million), mainly due to lower financing by Philips.

*Successor*

Interest expense, net of EUR 79 million was mainly related to the interest expense that was recorded in connection with the bridge financing facility (EUR 14 million) and the issuance of notes (EUR 74 million).
Foreign exchange results of EUR 48 million mainly include losses related to a bridge financing (EUR 28 million) and foreign exchange gains related to the USD denominated notes (EUR 111 million). Furthermore, an exchange loss of EUR 24 million was related to cash and cash equivalents.
Miscellaneous financing costs include fees related to the bridge financing and the amortization of fees relating to the issuance of notes (EUR 39 million).

## 10 Income taxes

The tax benefit on the loss before income tax for the period September 29, 2006 through December 31, 2006 amounted to EUR 242 million (January 1, 2006 through September 28, 2006: an expense of EUR 65 million, 2005: an expense of EUR 101 million, 2004: an expense of EUR 113 million).

There were no non reclaimable withholding taxes in 2006 during the predecessor or successor periods. In the tax expense of 2005 a non reclaimable withholding tax of EUR 38 million was included (2004: EUR 17 million).

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| The components of income tax benefit (expense) are as follows: | | | | |
| Netherlands: | | | | |
| Current taxes | - | (45) | (19) | **-** |
| Deferred taxes | (59) | (14) | - | **211** |
| | (59) | (59) | (19) | **211** |
| Foreign: | | | | |
| Current taxes | (39) | (104) | (64) | **(5)** |
| Deferred taxes | (15) | 62 | 18 | **36** |
| | (54) | (42) | (46) | **31** |
| Income tax (expense) benefit | (113) | (101) | (65) | **242** |

The Company's operations are subject to income taxes in various foreign jurisdictions. Excluding certain tax incentives, the statutory income tax rates vary from 17.5% to 41%.

A reconciliation of the statutory income tax rate in the Netherlands as a percentage of income before taxes and the effective income tax rate is as follows:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Statutory income tax in the Netherlands | 34.5 | 31.5 | 29.6 | **29.6%** |
| Rate differential local statutory rates versus statutory rates of the Netherlands | (5.6) | 28.1 | (2.6) | **(2.4%)** |
| Changes in the valuation allowance: | | | | |
| – utilization of previously reserved loss carryforwards | (23.4) | (50.3) | (5.0) | **-** |
| – new loss carryforwards not expected to be realized | 19.6 | 187.1 | 19.6 | **(0.7)** |
| – release and other changes | 34.4 | 34.2 | (11.4) | **(0.2)** |
| Non-taxable income | (4.5) | (9.7) | (2.9) | **0.8** |
| Non-tax-deductible expenses | 7.7 | 14.5 | 0.2 | **(0.1)** |
| Withholding and other taxes | 12.7 | 120.3 | 5.6 | **(0.1)** |
| Tax incentives and other | 4.7 | (91.1) | 23.0 | **1.5** |
| Effective tax rate | 80.1% | 264.6% | 56.1% | **28.4%** |

### Deferred tax assets and liabilities

Deferred tax assets and liabilities relate to the following balance sheet captions:

| | PREDECESSOR | | **SUCCESSOR** | |
|---|---|---|---|---|
| | As of December 31, 2005 | | **As of December 31, 2006** | |
| | assets | liabilities | **assets** | **liabilities** |
| Intangible assets | 4 | (3) | **127** | **(405)** |
| Property, plant and equipment | 60 | (26) | **8** | **(8)** |
| Inventories | 21 | (1) | **13** | **(6)** |
| Receivables | - | (4) | **1** | **(1)** |
| Other assets | 17 | (3) | **1** | **(1)** |
| Provisions: | | | | |
| – Pensions | 14 | - | **14** | **-** |
| – Restructuring | 2 | - | **-** | **-** |
| – Guarantees | 1 | - | **1** | **-** |
| – Other postretirement benefits | 7 | - | **7** | **-** |
| – Other | 45 | - | **9** | **-** |
| Other liabilities | 141 | (1) | **2** | **(10)** |
| Tax loss carryforwards (including tax credit carryforwards) | 547 | - | **157** | **-** |
| Total deferred tax assets (liabilities) | 859 | (38) | **340** | **(431)** |
| Net deferred tax position | 821 | | **(91)** | |
| Valuation allowances | (694) | | **(51)** | |
| Net deferred tax assets (liabilities) | 127 | | **(142)** | |

In assessing the Company's ability to realize deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income in the countries where the net operating losses were incurred. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowance at December 31, 2006.

The valuation allowance for deferred tax assets as of December 31, 2006 and 2005 was EUR 51 million and EUR 694 million respectively.

The net changes in the total valuation allowance for the successor period September 29, 2006 through December 31, 2006 was an increase of EUR 15 million.

The net changes in the total valuation allowance for the predecessor periods January 1, 2006 through September 28, 2006, the years ended December 31, 2005 and 2004, were an increase of EUR 4 million, an increase of EUR 160 million and a decrease of EUR 23 million, respectively.

The portion of the valuation allowance as of December 31, 2006, relating to deferred tax assets, for which subsequently recognized tax benefits will be allocated to reduce goodwill or other intangible assets of an acquired entity or directly to contributed capital, amounts to EUR 11 million (2005: EUR 14 million).

At December 31, 2006, operating loss carryforwards expire as follows:

| Total | 2007 | 2008 | 2009 | 2010 | 2011 | 2012-2016 | later | unlimited |
|---|---|---|---|---|---|---|---|---|
| 496 | - | - | 22 | - | 19 | 243 | - | 212 |

The Company also has tax credit carryforwards of EUR 12 million, which are available to offset future tax, if any, and which expire as follows:

| Total | 2007 | 2008 | 2009 | 2010 | 2011 | 2012-2016 | later | unlimited |
|---|---|---|---|---|---|---|---|---|
| 12 | 1 | 5 | 4 | 1 | - | - | - | 1 |

The classification of the deferred tax assets and liabilities in the Company's balance sheet is as follows:

| | PREDECESSOR | **SUCCESSOR** |
|---|---|---|
| | 2005 | **2006** |
| Deferred tax assets classified under other current assets | 24 | **23** |
| Deferred tax assets classified under other non-current assets | 114 | **86** |
| Deferred tax liabilities classified under provisions | (11) | **(251)** |
| | 127 | **(142)** |

Income tax payable, amounting to EUR 11 million as of December 31, 2006 includes amounts directly payable to tax authorities. As of December 31, 2005 income tax payable amounting to EUR 186 million represents intercompany payable to Philips related to income tax calculated on a separate tax return basis.

The amount of the unrecognized deferred income tax liability for temporary differences as of December 31, 2006, of EUR 11 million (2005: EUR 39 million) relates to unremitted earnings in foreign Group companies, which are considered to be permanently re-invested. Under current Dutch tax law, no additional taxes are payable. However, in certain jurisdictions, withholding taxes would be payable.

## 11 Investments in unconsolidated companies

### Results relating to unconsolidated companies

| | PREDECESSOR | | | **SUCCESSOR** |
|---|---|---|---|---|
| | For the years ended December 31, 2004 | For the years ended December 31, 2005 | For the period January 1, 2006 - September 28, 2006 | **For the period September 29, 2006 - December 31 2006** |
| Company's participation in income (loss) | 3 | (5) | (2) | **(2)** |
| Result on sale of shares | 9 | - | - | **-** |
| Gains arising from dilution effects | - | - | 5 | **-** |
| | 12 | (5) | 3 | **(2)** |

### Company's participation in income (loss)

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| ASMC | 6 | (3) | 1 | **-** |
| Others | (3) | (2) | (3) | **(2)** |
| | 3 | (5) | (2) | **(2)** |

### Result on sale of shares

In 2004, the shares in Computer Access Technology Corporation were sold resulting in a gain of EUR 9 million.

### Gains arising from dilution effects

The gain arising from dilution effects in the period January 1, 2006 through September 28, 2006, is related to the initial public offering by ASMC resulting in a dilution of NXP's shareholding from 37% to 27%.

### Investments in unconsolidated companies

The changes in the period January 1, 2006 through September 28, 2006 are as follows:

| PREDECESSOR | |
|---|---|
| Balance of equity method investments as of January 1, 2006 | 48 |
| Changes: | |
| Acquisitions/additions | 3 |
| Share in income (loss) on dilution gain | 3 |
| Translation and exchange rate differences | (1) |
| Balance of equity method investments as of September 28, 2006 | 53 |

Acquisitions relate to the acquisition of Sunext.

The changes in the period September 29, 2006 through December 31, 2006 are as follows:

| SUCCESSOR | |
|---|---|
| Balance of equity method investments as of September 29, 2006 | **49** |
| Changes: | |
| Acquisitions/additions | **3** |
| Sales/repayments | **(5)** |
| Share in income (loss) | **(2)** |
| Translation and exchange rate differences | **(1)** |
| Balance of equity method investments as of December 31, 2006 | **44** |

Acquisitions relate to the shareholding in T3G. Sales/repayments related to the repayment of a loan by T3G.

The total carrying value of investments in unconsolidated companies is summarized as follows:

| | PREDECESSOR | | SUCCESSOR | |
|---|---|---|---|---|
| | As of December 31, 2005 | | **As of December 31, 2006** | |
| | Shareholding % | Amount | **Shareholding %** | **Amount** |
| ASMC | 37 | 45 | **27** | **37** |
| Others | | 3 | | **7** |
| | | 48 | | **44** |

## 12 Minority interests

The share of minority interests in the results of the Company resulted in a charge to the combined and consolidated statements of operations of EUR 4 million, for the period September 29, 2006 through December 31, 2006 (January 1, 2006 through September 28, 2006: EUR 50 million; 2005: EUR 34 million; 2004: EUR 26 million).

In the period September 29, 2006 through December 31, 2006, minority interests in consolidated companies decreased with EUR 45 million due to the incremental 10.7% acquisition of SSMC shares. Refer to note 6.
As of December 31, 2006, minority interests in consolidated companies totaled EUR 162 million (2005: EUR 173 million).

In 2006 and 2005, minority interests almost fully relates to the shareholding in SSMC in Singapore.

## 13 Receivables

Accounts receivable are summarized as follows:

| | PREDECESSOR | SUCCESSOR |
|---|---|---|
| | As of December 31, 2005 | **As of December 31, 2006** |
| Accounts receivable from third parties | 536 | **501** |
| Accounts receivable from unconsolidated companies | 1 | **3** |
| Less: allowance for doubtful accounts | (3) | **(3)** |
| | 534 | **501** |

## 14 Inventories

Inventories are summarized as follows:

| | PREDECESSOR | SUCCESSOR |
|---|---|---|
| | As of December 31, 2005 | **As of December 31, 2006** |
| Raw materials and supplies | 368 | **317** |
| Work in process | 141 | **128** |
| Finished goods | 187 | **201** |
| | 696 | **646** |

A portion of the finished goods stored at customer locations under consignment amounted to EUR 38 million as of December 31, 2006 (2005: EUR 37 million).

The amounts recorded above are net of an allowance for obsolescence.

## 15 Other current assets

Other current assets as of December 31, 2006, consist of a current deferred tax asset of EUR 23 million (2005: EUR 24 million), derivative instrument assets of EUR 8 million (2005: EUR 9 million), the current portion of capitalized unamortized fees related to the issuance of notes of EUR 11 million (2005: nil) and prepaid expenses of EUR 83 million (2005: EUR 73 million).

## 16 Other non-current assets

Other non-current assets as of December 31, 2006 are comprised of prepaid pension costs of nil (2005: EUR 8 million), the non-current portion of deferred tax assets of EUR 86 million (2005: EUR 114 million), the non-current portion of capitalized unamortized fees related to the issuance of notes of EUR 71 million (2005: nil), and non-current financial assets of EUR 12 million (2005: EUR 7 million), mainly consisting of long-term receivables from Laguna Ventures Inc. in The Philippines.
The term of amortization of capitalized fees related to the issuance cost of notes is on average 7 years.

## 17 Property, plant and equipment

Property, plant and equipment consisted of:

| | PREDECESSOR | | **SUCCESSOR** | |
|---|---|---|---|---|
| | As of December 31, 2005 | | **As of December 31, 2006** | |
| | cost | accumulated depreciation | **cost** | **accumulated depreciation** |
| Land and buildings | 1,314 | (765) | **720** | **(15)** |
| Machinery and installations | 5,875 | (4,590) | **1,497** | **(147)** |
| Other equipment | 376 | (262) | **126** | **(9)** |
| Prepayments and construction in progress | 108 | - | **112** | **-** |
| No longer productively employed | 15 | (15) | **-** | **-** |
| | 7,688 | (5,632) | **2,455** | **(171)** |
| Accumulated depreciation – total | (5,632) | | **(171)** | |
| Book value | 2,056 | | **2,284** | |

Land with a book value of EUR 89 million (2005: EUR 42 million) is not depreciated.

The expected service lives as of December 31, 2006 are as follows:

| | |
|---|---|
| Buildings | from 12 to 50 years |
| Machinery and installations | from 2 to 7 years |
| Lease assets | from 3 to 10 years |
| Other equipment | from 3 to 10 years |

The expected service lives as of December 31, 2005 are as follows:

| | |
|---|---|
| Buildings | from 20 to 25 years |
| Machinery and installations | from 5 to 7 years |
| Lease assets | from 3 to 10 years |
| Other equipment | from 3 to 10 years |

Capital expenditures include capitalized interest related to the construction in progress amounting to nil in 2006 (2005: EUR 2 million).

# 18 Intangible assets excluding goodwill

*Predecessor*

The changes in the period January 1, 2006 through September 28, 2006 were as follows:

| | total | other intangible assets | software |
|---|---|---|---|
| Balance as of January 1, 2006: | | | |
| Cost | 527 | 287 | 240 |
| Accumulated amortization | (469) | (278) | (191) |
| Book value | 58 | 9 | 49 |
| | | | |
| Changes in book value: | | | |
| Acquisitions/additions | 16 | - | 16 |
| Amortization | (19) | (9) | (10) |
| Translation differences | (1) | - | (1) |
| Total changes | (4) | (9) | 5 |
| | | | |
| Balance as of September 28, 2006: | | | |
| Cost | 504 | 265 | 239 |
| Accumulated amortization | (450) | (265) | (185) |
| Book value | 54 | - | 54 |

*Successor*

The changes in the period September 29, 2006 through December 31, 2006 were as follows:

| | total | other intangible assets | software |
|---|---|---|---|
| Balance as of September 29, 2006: | | | |
| Cost | **3,690** | **3,636** | **54** |
| Accumulated amortization | **-** | **-** | **-** |
| Book value | **3,690** | **3,636** | **54** |
| | | | |
| Changes in book value: | | | |
| Acquisitions/additions | **15** | **10** | **5** |
| Amortization | **(125)** | **(119)** | **(6)** |
| Write-off in-process research and development | **(515)** | **(515)** | **-** |
| Total changes | **(625)** | **(624)** | **(1)** |
| | | | |
| Balance as of December 31, 2006: | | | |
| Cost | **3,190** | **3,131** | **59** |
| Accumulated amortization | **(125)** | **(119)** | **(6)** |
| Book value | **3,065** | **3,012** | **53** |

Acquisitions/additions in other intangible assets relate to the incremental 10.7% purchase of additional shares in SSMC. Refer to note 6.

Other intangible assets as of December 31 consist of:

| | PREDECESSOR | | SUCCESSOR | |
|---|---|---|---|---|
| | As of December 31, 2005 | | **As of December 31, 2006** | |
| | gross | Accumulated amortization | **gross** | **Accumulated amortization** |
| Marketing-related | - | - | **85** | **(4)** |
| Customer-related | - | - | **639** | **(22)** |
| Technology-based | 287 | (278) | **2,407** | **(93)** |
| | 287 | (278) | **3,131** | **(119)** |

The estimated amortization expense for these other intangible assets as of December 31, 2006 for each of the five succeeding years are:

| | |
|---|---|
| 2007 | 461 |
| 2008 | 426 |
| 2009 | 398 |
| 2010 | 301 |
| 2011 | 258 |

All intangible assets, excluding goodwill, are subject to amortization and have no assumed residual value.

The estimated amortization expense for software as of December 31, 2006 for each of the five succeeding years are:

| | |
|---|---|
| 2007 | 18 |
| 2008 | 18 |
| 2009 | 17 |
| 2010 | - |
| 2011 | - |

The expected weighted average remaining life of other intangibles is 5 year as of December 31, 2006. The expected weighted average remaining lifetime of software is 2 years as of December 31, 2006.

## 19 Goodwill

The changes in goodwill were as follows:

| | PREDECESSOR | | SUCCESSOR |
|---|---|---|---|
| | For the year ended December 31, 2005 | For the period January 1, 2006 - September 28, 2006 | **For the period September 29 - December 31, 2006** |
| Book value at begin of period | 178 | 213 | **2,005** |
| Changes in book value: | | | |
| Acquisitions | 14 | - | **27** |
| Translation differences | 21 | (13) | **-** |
| Book value at end of period | 213 | 200 | **2,032** |

Acquisitions in 2006 for the successor period include goodwill related to the incremental 10.7% purchase of additional shares in SSMC. Refer to note 6. In 2005, it included the goodwill paid on the acquisition of a 2.5% interest in SSMC for EUR 14 million. Please refer to note 4 for a specification of goodwill by segment.

## 20 Accrued liabilities

Accrued liabilities are summarized as follows:

| | PREDECESSOR As of December 31, 2005 | SUCCESSOR As of December 31, 2006 |
|---|---|---|
| Personnel-related costs: | | |
| Salaries and wages | 112 | **114** |
| Accrued vacation entitlements | 46 | **56** |
| Other personnel-related costs | 20 | **53** |
| Utilities, rent and other | 25 | **30** |
| Income tax payable | 186 | **11** |
| Communication & IT costs | 23 | **20** |
| Distribution costs | 10 | **10** |
| Purchase-related costs | 25 | **21** |
| Interest accruals | 9 | **81** |
| Derivative instruments - liabilities | 41 | **1** |
| Liabilities for restructuring costs (refer to note 8) | 18 | **8** |
| Other accrued liabilities | 33 | **80** |
| | 548 | **485** |

## 21 Provisions

Provisions are summarized as follows:

| | PREDECESSOR As of December 31, 2005 | | SUCCESSOR As of December 31, 2006 | |
|---|---|---|---|---|
| | long – term | short – term | **long – term** | **short - term** |
| Pensions for defined-benefit plans (refer to note 22) | 53 | 2 | **97** | **15** |
| Other postretirement benefits (refer to note 23) | - | 3 | **-** | **1** |
| Postemployment benefits and severance payments | - | 6 | **1** | **1** |
| Deferred tax liabilities (refer to note 10) | 11 | - | **251** | **-** |
| Product warranty | - | 5 | **-** | **6** |
| Loss contingencies | 12 | 4 | **1** | **2** |
| Other provisions | 12 | 33 | **18** | **29** |
| Total | 88 | 53 | **368** | **54** |

The changes in total provisions excluding deferred tax liabilities are as follows:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 – September 28, 2006 | **For the period September 29, 2006 – December 31, 2006** |
| | 2004 | 2005 | | |
| Beginning balance | 152 | 127 | 130 | **162** |
| Changes: | | | | |
| Additions | 16 | 31 | 25 | **15** |
| Utilizations | (26) | (32) | (24) | **(5)** |
| Releases | (4) | (5) | (1) | **-** |
| Translation differences | (4) | 9 | (4) | **(1)** |
| Changes in consolidation | (7) | - | - | **-** |
| Ending balance | 127 | 130 | 126 | **171** |

## Postemployment benefits and obligatory severance payments

The provision for postemployment benefits covers benefits provided to former or inactive employees after employment but before retirement, including salary continuation, supplemental unemployment benefits and disability-related benefits.

The provision for severance payments covers the Company's commitment to pay employees a lump sum upon the employee's dismissal or resignation. In the event that a former employee has passed away, in certain circumstances the Company pays a lump sum to the deceased employee's relatives.

## Product warranty

The provision for product warranty reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to products sold. The changes in the provision for product warranty are as follows:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, 2006 | **For the period September 29, 2006 - December 31, 2006** |
| | 2004 | 2005 | | |
| Beginning balance | 7 | 8 | 5 | **7** |
| Changes: | | | | **-** |
| Additions | 3 | - | 2 | **-** |
| Utilizations | (2) | (1) | - | **(1)** |
| Releases | - | (3) | - | **-** |
| Changes in consolidation | - | 1 | - | **-** |
| Ending balance | 8 | 5 | 7 | **6** |

### Loss contingencies (environmental remediation and product liability)

This provision includes expected losses recorded with respect to environmental remediation and product liability obligations which are deemed probable and reasonably estimatable. The changes in this provision are as follows:

| | PREDECESSOR | | | SUCCESSOR |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Beginning balance | 16 | 16 | 16 | **2** |
| Changes: | | | | |
| Additions | 3 | - | - | **1** |
| Utilizations | (1) | (2) | (3) | **-** |
| Translation differences | (2) | 2 | (1) | **-** |
| Ending balance | 16 | 16 | 12 | **3** |

Philips has assumed obligations related to the environmental remediation that existed at the date of the Acquisition, primarily at certain closed sites in the United States. The Company has not incurred material environmental remediation obligations since the Acquisition. The remaining balance as of December 31, 2006 relates to minor product liability contingencies.

### Other provisions

Other provisions include provisions for employee jubilee funds totaling EUR 28 million as of December 31, 2006 (2005: EUR 22 million).

## 22 Pensions

The Company does not sponsor material postretirement benefits other than pensions. Our employees participate in employee pension plans in accordance with the legal requirements, customs and the local situation in the respective countries.

The majority of the employees in Europe are covered by defined- benefit pension plans. The benefits provided by these plans are based on employees' years of service and compensation levels. For other countries defined- contribution pension plans are more common. The measurement date for all defined- benefit pension plans is December 31. Contributions are made by the Company, as necessary, to provide assets sufficient to meet the benefits payable to defined-benefit pension plan participants.

These contributions are determined based upon various factors, including funded status, legal and tax considerations as well as local customs. The Company funds certain defined-benefit pension plans as claims are incurred.

The pension plans have been established by Philips. During the predecessor period the costs of pension benefits with respect to the Company's employees participating in these plans have been allocated to the Company based upon actuarial computations, except for certain less significant plans, in which case a proportional allocation based upon compensation or headcount has been used. The amounts included in the combined statements of operations for 2004, 2005 and January 1, 2006 through September 28, 2006 were EUR 58 million, EUR 64 million and EUR 51 million, respectively. Related assets and liabilities are not included in the Company's predecessor balance sheet. At the Separation the Company disentangled the majority of its pension plans. Full disentanglement of remaining plans is expected to be completed before October 1, 2007.

For the Netherlands the disentanglement will be finalized one year after the Separation. During this one year period, the employees will participate in the Dutch Philips pension fund. It has been assumed that a transfer will take place and that the amount of plan assets transferred will equal the required reserves to offer equivalent benefits.

For pension plans in which only the Company's employees participate (the Company's dedicated plans), the related costs, assets and liabilities have been included in the combined and consolidated balance sheets.

For the period prior to the Separation, the Philips sponsored pension plans in which the Company and other Philips businesses participated have been treated as multi-employer plans (non-Company dedicated plans).

The table below provides a summary of the changes in the pension benefit obligations and defined-benefit pensions plan assets for 2006 and 2005, with respect to the Company's dedicated plans, and a reconciliation of the funded status of these plans to the amounts recognized in the combined and consolidated balance sheets.

| | PREDECESSOR As of December 31, 2005 | **SUCCESSOR As of December 31, 2006** |
|---|---|---|
| Projected benefit obligation | | |
| Projected benefit obligation at beginning of year | 151 | **188** |
| Additions | - | **746** |
| Service cost | 8 | **16** |
| Interest cost | 8 | **10** |
| Actuarial (gains) and losses | 19 | **-** |
| Settlements | (2) | **-** |
| Benefits paid | (5) | **(3)** |
| Exchange rate differences | 9 | **(1)** |
| Projected benefit obligation at end of year | 188 | **956** |
| Plan assets | | |
| Fair value of plan assets at beginning of year | 87 | **98** |
| Additions | - | **603** |
| Actual return on plan assets | 6 | **9** |
| Employer contributions | 6 | **16** |
| Benefits paid | (2) | **(3)** |
| Exchange rate differences | 1 | **(1)** |
| Fair value of plan assets at end of year | 98 | **722** |
| Funded status | (90) | **(234)** |
| Unrecognized net transition obligation | 1 | **-** |
| Unrecognized prior service cost | 1 | **-** |
| Unrecognized net loss | 39 | **-** |
| Net balance | (49) | **(234)** |
| Classification of the net balances is as follows: | | |
| - Prepaid pension costs under other non-current assets | 8 | **-** |
| - Accrued pension costs under other non-current liabilities | (2) | **(122)** |
| - Provisions for pensions under provisions | (55) | **(112)** |
| Total | (49) | **(234)** |

The weighted average assumptions used to calculate the projected benefit obligations were as follows:

| | PREDECESSOR As of December 31, 2005 | **SUCCESSOR As of December 31, 2006** |
|---|---|---|
| Discount rate | 4.4% | **4.4%** |
| Rate of compensation increase | 3.5% | **3.1%** |

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for both funded and unfunded defined-benefit pension plans with accumulated benefit obligations in excess of plan assets are included in the table below:

| | PREDECESSOR | **SUCCESSOR** |
|---|---|---|
| | As of December 31, 2005 | **As of December 31, 2006** |
| Projected benefit obligation | 77 | **230** |
| Accumulated benefit obligation | 54 | **181** |
| Fair value of plan assets | 4 | **53** |

The weighted-average assumptions used to calculate the net periodic pension cost were as follows:

| | PREDECESSOR | | | **SUCCESSOR** |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Discount rate | 4.8% | 4.8% | 4.4% | **4.4%** |
| Expected returns on plan assets | 4.2% | 4.4% | 4.3% | **5.3%** |
| Rate of compensation increase | 3.1% | 3.5% | 3.6% | **3.1%** |

The components of net periodic pension costs were as follows:

| | PREDECESSOR | | | **SUCCESSOR** |
|---|---|---|---|---|
| | For the years ended December 31, | | For the period January 1, 2006 - September 28, | **For the period September 29, 2006 - December 31,** |
| | 2004 | 2005 | 2006 | **2006** |
| Service cost | 7 | 8 | 7 | **16** |
| Interest cost on the projected benefit | 7 | 8 | 7 | **10** |
| Expected return on plan assets | (3) | (4) | (4) | **(9)** |
| Net amortization of unrecognized net assets/liabilities | 1 | - | - | **-** |
| Net actuarial loss recognized | - | 1 | 1 | **-** |
| Other | 1 | - | - | **1** |
| Net periodic cost | 13 | 13 | 11 | **18** |

The Company also sponsors defined-contribution plans and similar plans. The total cost of these plans amounted to EUR 8 million for the period September 29, 2006 through December 31, 2006 (January 1, 2006 through September 28, 2006: EUR 10 million, 2005: EUR 12 million, 2004: EUR 9 million).

The Company expects to make cash contributions in relation to defined-benefit plans amounting to EUR 55 million in 2007.

### Estimated future pension benefit payments

The following benefit payments are expected to be made:

| | |
|---|---|
| 2007 | 9 |
| 2008 | 11 |
| 2009 | 12 |
| 2010 | 14 |
| 2011 | 16 |
| Years 2012-2016 | 153 |

| | PREDECESSOR<br>As of December 31, 2005 | **SUCCESSOR**<br>**As of December 31, 2006** |
|---|---|---|
| Accumulated benefit obligation for all Company-dedicated benefit pension plans | 142 | **768** |

### Plan assets

The actual and targeted pension plan asset allocation at December 31, 2005 and 2006 is as follows:

| | PREDECESSOR<br>As of December 31, 2005 | **SUCCESSOR**<br>**As of December 31, 2006** |
|---|---|---|
| Asset category: | | |
| Equity securities | 6% | **27%** |
| Debt securities | 80% | **57%** |
| Other | 14% | **16%** |
| | 100% | **100%** |

The investment objectives for the pension plan assets are designed to generate returns that, along with the future contributions, will enable the pension plans to meet their future obligations.

## 23 Postretirement benefits other than pensions

Prior to the Separation, the Company's employees in certain countries participated in Philips sponsored plans that provide other postretirement benefits, primarily retiree healthcare benefits. The costs of other postretirement benefits, with respect to the Company's employees, have been allocated to the Company based upon headcount and actuarial calculations. After the Separation, these plans have been closed with the exception of a small group of employees in the United Kingdom and a larger group in the USA.

The amounts included in the combined and consolidated statements of operations for the period September 29, 2006 through December 31, 2006, the period January 1, 2006 through September 28, 2006, for 2005 and 2004 are expense of EUR 1 million, expense of EUR 1 million, income of EUR 19 million, and expense of EUR 8 million, respectively.

The recognition of income in 2005 is a result of a release of the postretirement obligation. The release was triggered by a change in Dutch law relating to the treatment of medical insurance costs.

## 24 Other current liabilities

Other current liabilities are summarized as follows:

| | PREDECESSOR As of December 31, 2005 | **SUCCESSOR As of December 31, 2006** |
|---|---|---|
| Advances received from customers on orders not covered by work in process | 3 | **5** |
| Other taxes including social security premiums | 43 | **39** |
| Other short-term liabilities | 9 | **1** |
| Total | 55 | **45** |

## 25 Short-term debt

| | PREDECESSOR As of December 31, 2005 | **SUCCESSOR As of December 31, 2006** |
|---|---|---|
| Short-term bank borrowings | 32 | **20** |
| Other short-term loans | - | **1** |
| Current portion of long-term debt | 115 | **2** |
| Total | 147 | **23** |

*Predecessor*

As at the end of December 2005 the current portion of long-term debt includes an amount of EUR 43 million related to a 4.25% fixed rate loan of SGD 600 million due in September 2006 and an amount of EUR 70 million related to a USD 200 million term loan with a total amount of USD 170 million outstanding at December 2005. Both loans were recorded by System on Silicon Manufacturing Company in Singapore.

During 2005 the weighted average interest rate on the bank borrowings was 3.8% (2004: 3.2%).

*Successor*

As at the end of December 2006 short-term bank borrowings consisted of bank loans recorded in our Chinese organizations in Guangdong (EUR 14 million) and Jilin (EUR 6 million).

During 2006 the weighted average interest rate on these loans was 6.0%.

## 26 Long-term debt

| | Range of interest rates | average rate of interest | amount outstanding 2006 | due in 2007 | due after 2007 | due after 2011 | SUCCESSOR average remaining term (in years) | PREDECESSOR amount outstanding December 31, 2005 |
|---|---|---|---|---|---|---|---|---|
| Euro notes | 6.2-8.6 | 7.0 | 1,525 | - | 1,525 | 1,525 | 7.6 | - |
| USD notes | 7.9-9.5 | 8.5 | 2,890 | - | 2,890 | 2,890 | 7.8 | - |
| Bank borrowings | 4.1-4.8 | 4.4 | 1 | - | 1 | - | 1.5 | 281 |
| Liabilities arising from capital lease transactions | 5.9-6.0 | 5.9 | 8 | 2 | 6 | 2 | 5.8 | 9 |
| Other long-term debt | 2.1-2.1 | 2.1 | 4 | - | 4 | 3 | 4.6 | 49 |
| | | 8.0 | 4,428 | 2 | 4,426 | 4,420 | 7.7 | 339 |
| PREDECESSOR | | | | | | | | |
| Corresponding data previous year | | 5.0 | 339 | 115 | 224 | 7 | 3.0 | |

The following amounts of long-term debt as of December 31, 2006 are due in the next 5 years:

| | |
|---|---|
| 2007 | 2 |
| 2008 | 3 |
| 2009 | 1 |
| 2010 | 1 |
| 2011 | 1 |
| | 8 |
| PREDECESSOR | |
| Corresponding amount previous year | 332 |

*Predecessor*

At the end of December 2005 long-term debt primarily consisted of bank borrowings. These mainly consisted of a syndicated loan to SSMC in Singapore, which had an outstanding balance at December 31, 2005 of EUR 141 million, and a bank loan to Philips Semiconductors, Inc. in the Philippines with an outstanding balance at the end of 2005 of EUR 140 million. The loan to SSMC has a balance of EUR 70 million payable within 12 months, which has been classified as part of short-term debt. The remaining balance is payable in 2007. The average interest rate applied to this loan in 2005 was 4.3%. The average remaining period was 1.6 years at the end of 2005.
The loan to Philips Semiconductors, Inc. has various maturity dates from 2007 to 2010. The average interest rate applied to this loan in 2005 was 6.2% and the average remaining period was 3.5 years. Both above mentioned loans have been fully repaid before the Separation from Philips.
At the end of December 31, 2005, the Company had outstanding loans with Philips of EUR 1,112 million. Please refer to note 5.

*Successor*

Related to the Acquisition, NXP issued on October 12, 2006 several series of notes with maturities ranging from 7 to 9 years and a mix of floating and fixed rates. Several series are denominated in US dollar and several series are euro denominated.  The euro and US dollar notes represent 34% and 66% respectively of the total notes outstanding. The series with tenors of 7 and 8 years are secured as described below; the series with a tenor of 9 years are unsecured.

### Euro Notes

The Euro notes comprise of the following two series:

- a EUR 1,000 million aggregate principal amount of floating rate senior secured notes due 2013 with an interest rate of three-month EURIBOR plus 2.75%, except that the interest rate for the period beginning on the date these notes were offered, October 12, 2006 through January 14, 2007 the interest rate was 6.214%; and
- a EUR 525 million aggregate principal amount of 8.625% senior notes due 2015.

No redemptions on any of these series have been made; both series are fully outstanding at their original principal euro amount at year-end 2006.

### USD Notes

The USD notes comprise of the following three series:

- a USD 1,535 million aggregate principal amount of floating rate senior secured notes due 2013 with an interest rate of three-month LIBOR plus 2.75%, except that the interest rate for the period beginning on the date these notes were offered, October 12, 2006 through January 14, 2007 the interest rate was 8.118%; and
- a USD 1,026 million aggregate principal amount of 7.875% senior secured notes due 2014; and
- a USD 1,250 million aggregate principal amount of 9.5% senior notes due 2015.

No redemptions on any of these series have been made; all three series are fully outstanding at their original principal US dollar amount at year-end 2006.

### Certain terms and Covenants of the Euro and USD Notes

The Company is not required to make mandatory redemption payments or sinking fund payments with respect to the notes.

The indentures governing the notes contain covenants that, among other things, limit the Company's ability and that of restricted subsidiaries to incur additional indebtedness, create liens, pay dividends, redeem capital stock or make certain other restricted payments or investments; enter into agreements that restrict dividends from restricted subsidiaries; sell assets, including capital stock of restricted subsidiaries; engage in transactions with affiliates; and effect a consolidation or merger.

Certain portions of long-term and short-term debt as of December 31, 2006 in the amount of EUR 2,959 million have been secured by collateral on substantially all of the Company's assets and of certain of its subsidiaries.

The notes are fully and unconditionally guaranteed jointly and severally, on a senior basis by certain of the Company's current and future material wholly-owned subsidiaries ("Guarantors").

Pursuant to various security documents related to the above mentioned secured notes and the EUR 500 million committed revolving credit facility, the Company and each Guarantor has granted first priority liens and security interests in, amongst others, the following, subject to the grant of further permitted collateral liens:

(a) all present and future shares of capital stock of (or other ownership or profit interests in) each of its present and future direct subsidiaries, other than SMST Unterstützungskasse GmbH, and material joint venture entities;

(b) all present and future intercompany debt of the Company and each Guarantor;

(c) all of the present and future property and assets, real and personal, of the Company, and each Guarantor, including, but not limited to, machinery and equipment, inventory and other goods, accounts receivable, owned real estate, leaseholds, fixtures, general intangibles, license rights, patents, trademarks, trade names, copyrights, chattel paper, insurance proceeds, contract rights, hedge agreements, documents, instruments, indemnification rights, tax refunds, but excluding cash and bank accounts; and

(d) all proceeds and products of the property and assets described above.

Notwithstanding the foregoing, certain assets may not be pledged (or the liens not perfected) in accordance with agreed security principles, including:

- if the cost of providing security is not proportionate to the benefit accruing to the holders;
- if providing such security requires consent of a third party and such consent cannot be obtained after the use of commercially reasonable efforts; and
- if providing such security would be prohibited by applicable law, general statutory limitations, financial assistance, corporate benefit, fraudulent preference, "thin capitalization" rules or similar matters or providing security would be outside the applicable pledgor's capacity or conflict with fiduciary duties of directors or cause material risk of personal or criminal liability after using commercially reasonable efforts to overcome such obstacles;
- if providing such security would have a material adverse effect (as reasonably determined in good faith by such subsidiary) on the ability of such subsidiary to conduct its operations and business in the ordinary course as otherwise permitted by the indenture; and
- if providing such security or perfecting liens thereon would require giving notice (i) in the case of receivables security, to customers or (ii) in the case of bank accounts, to the banks with whom the accounts are maintained. Such notice will only be provided after the secured notes are accelerated.

Subject to agreed security principles, if material property is acquired by the Company or a Guarantor that is not automatically subject to a perfected security interest under the security documents, then the Company or relevant Guarantor will within 60 days provide security over this property and deliver certain certificates and opinions in respect thereof as specified in the indenture governing the notes.

### Credit facilities

*Predecessor*

As at the end of December 2005 the Company had a USD 400 million syndicated credit facility in Singapore, comprising of a USD 200 million term loan, of which USD 167 million (EUR 141 million) was outstanding as at 31 December 2005, and a USD 200 million revolving credit facility which was undrawn as at 31 December 2005. For this facility, EUR 425 million of property, plant and equipment and EUR 154 million of other assets were provided as collateral.
The above mentioned loans of SSMC have been fully repaid and cancelled before the Separation from Philips.

*Successor*

As of September 29, 2006, the Company entered into a senior secured revolving credit facility for an aggregate principal amount of EUR 500 million to finance the working capital requirements and general corporate purposes. This committed revolving credit facility has a tenor of 6 years and expires in 2012. All of the Guarantors of the secured notes described above are also guarantor of our obligations under this committed revolving credit facility and similar security as granted under the secured notes has been granted for the benefit of the lenders under this facility.

## 27 Other non-current liabilities

Other non-current liabilities are summarized as follows:

| | PREDECESSOR As of December 31, 2005 | **SUCCESSOR As of December 31, 2006** |
|---|---|---|
| Accrued pension costs | 2 | **122** |
| Asset retirement obligations | 5 | **4** |
| Liabilities for restructuring costs | 2 | **4** |
| | 9 | **130** |

## 28 Leases

### Capital leases

Property, plant and equipment includes EUR 8 million as of December 31, 2006 (2005: EUR 9 million) for capital leases and other beneficial rights of use, such as building rights and hire purchase agreements. The financial obligations arising from these contractual agreements are reflected in long-term debt.

### Operating leases

Long-term operating lease commitments totaled EUR 89 million as of December 31, 2006 (2005: EUR 58 million). The long-term operating leases are mainly related to the rental of buildings. These leases expire at various dates during the next 30 years. The future payments that fall due in connection with these obligations are as follows:

| | |
|---|---|
| 2007 | 23 |
| 2008 | 14 |
| 2009 | 8 |
| 2010 | 7 |
| 2011 | 7 |
| Later | 30 |
| Total | 89 |

## 29 Other commitments and contingent liabilities

### Guarantees

In the normal course of business, the Company issues certain guarantees. Guarantees issued or modified after December 31, 2002, having characteristics defined in FIN 45, are measured at fair value and recognized on the balance sheet. At the end of 2006 there were no material guarantees recognized by the Company.
Guarantees issued before December 31, 2002 and not modified afterwards, and certain guarantees issued after December 31, 2002, which do not have characteristics as defined in FIN 45, remain off-balance sheet. At the end of 2006 there were no such guarantees recognized.

### Other commitments

The Company has made certain commitments to SSMC, whereby the Company is obligated to make cash payments to SSMC should it fail to purchase an agreed-upon percentage of the total available capacity at SSMC's fabrication facilities if overall SSMC utilization levels drop below a fixed proportion of the total available capacity. In the periods presented in these financial statements no such payments were made. Furthermore, other commitments exist with respect to long-term obligations for a joint development contract with Catena Holding BV of EUR 21 million and with respect to long-term software license contracts of EUR 53 million, among others with Synopsis and Cadence.

### Environmental remediation

The Company accrues for losses associated with environmental obligations when such losses are probable and reasonably estimable. Refer to note 21 to the combined and consolidated financial statements for a specification of provisions for environmental remediation.

### Litigation

The Company and certain of its businesses are involved as plaintiffs or defendants in litigation relating to such matters as commercial transactions, intellectual property rights and product liability. Although the ultimate disposition of asserted claims and proceedings cannot be predicted with certainty, it is the opinion of the Company's management that the outcome of any such claims, either individually or on a combined basis, will not have a material adverse effect on the Company's combined or consolidated financial position, but may be material to the consolidated statement of operations of the Company for a particular period.

## 30 Share-based compensation

Until the Separation from Philips, on September 28, 2006, the Company participated in Philips' share-based compensation plans. Under these plans, Philips has granted share options on its common shares and rights to receive common shares in the future (restricted share rights) to certain Company employees. The employee awards were previously granted by Philips to its employees and have been subsequently allocated to the Company. Under the Philips plans, options were granted at fair market value on the date of grant.

Immediately before the date of acquisition of our Company by KASLION, Philips announced all outstanding unvested stock options and restricted share rights related to employees of the semiconductor businesses of Philips would become fully vested and exercisable on October 16, 2006, which was recorded as part of the purchase allocation.

For the successor period there is no share-based plan in place for non-executive employees and, as such, no new share-based compensation arrangements were granted to non-executive employees in the period from September 29, 2006 through December 31, 2006.

From 2003 to September 28, 2006, Philips issued restricted share rights to certain Company's employees that vest in equal annual installments over a three-year period. Restricted shares are Philips shares that the grantee will receive in three successive years, provided the grantee is still with Philips on the respective delivery dates. If the grantee still holds the shares after three years from the delivery date, Philips will grant 20% additional (premium) shares, provided the grantee is still with Philips.

From 2002, Philips granted fixed share options to certain Company's employees that expire upon the earlier of 10 years after the grant, or 5 years after the termination of the grantee's employment with Philips. Generally, the options vest after 3 years; however, a limited number of options granted to certain employees of acquired businesses contain accelerated vesting. In prior years, fixed and variable (performance) options were issued with terms of ten years, vesting one to three years after grant. In contrast to 2001 and certain prior years, when variable (performance) share options were issued, the share-based compensation grants from 2002 consider the performance of Philips versus a peer group of multinationals.
USD-denominated share options and restricted share rights are granted to employees in the United States only.

Under the terms of employee share purchase plans established by Philips in various countries, substantially all employees in those countries are eligible to purchase a limited number of shares of Philips share at discounted prices through payroll withholdings, of which the maximum ranges from 8.5% to 10% of total salary. Generally, the discount provided to the employees is between the range of 10% to 20%. In 2004 and certain prior years, the purchase price in the United States equaled the lower of 85% of the closing price at the beginning or end of quarterly purchase periods.

In The Netherlands, and through September 28, 2006, Philips issued personnel debentures to the Company's employees with a 5-year right of conversion into common shares of Philips. The conversion price is equal to the current share price at the date of issuance. The fair value of the conversion option of EUR 6.41 in 2006 (predecessor period) (EUR 5.85 in 2005 and EUR 6.05 in 2004) is recorded as compensation expense over the period of vesting.

Effective January 1, 2006, the Company adopted SFAS 123(R) using the modified prospective method for the transition. Since the Company had previously adopted the fair value provisions of SFAS 123 prospectively for all employer awards granted, modified or settled after January 1, 2003, the adoption of SFAS 123(R) did not have a material impact on the Company's financial position or results of operations.
An expense of EUR 15 million was recorded in the period January 1, 2006 through September 28, 2006 for share-based compensation (2005: EUR 19 million, 2004: EUR 18 million).

Prior to 2003, the Company accounted for share-based compensation using the intrinsic value method, and the recognition and measurement provisions of APB Opinion No. 25, 'Accounting for Stock Issued to Employees', and related interpretations.

Since awards issued under Philips plans prior to 2003 generally vested over three years, the cost related to share-based compensation included in the determination of net income (loss) for 2005 and 2004 is less than that which would have been recognized if the fair value method had been applied to all outstanding awards. There was no impact for 2006.

Pro forma net income (loss), calculated as if the Company had applied the fair value recognition provisions for all outstanding and unvested awards in each period, amounted to a loss of EUR 103 million and EUR 1 million for 2005 and 2004 respectively. Please refer to stock-based compensation under accounting policies for a reconciliation of reported and pro forma income (loss).

Pro forma net income (loss) may not be representative of that to be expected in future years.

In accordance with SFAS 123(R), the fair value of share options granted is required to be based upon a statistical option valuation model.

Since the Philips share options are not traded on any exchange, employees can neither receive any value nor derive any benefit from holding these share options without an increase in the market price of Philips' shares.

The fair value of the Philips option grants was estimated using a Black-Scholes option valuation model and the following weighted average assumptions:

| | For the years ended December 31, | | For the period January 1, 2006 – September 28, |
|---|---|---|---|
| | 2004 | 2005 | 2006 |
| | (EUR-denominated) | | |
| Risk-free interest rate | 3.33% | 2.89% | 3.63% |
| Expected dividend yield | 1.8% | 1.8% | 1.8% |
| Expected stock price volatility | 48% | 44% | 39% |
| Expected option life | 5 yrs | 5 yrs | 6 yrs |

| | For the years ended December 31, | | For the period January 1, 2006 – September 28, |
|---|---|---|---|
| | 2004 | 2005 | 2006 |
| | (USD-denominated) | | |
| Risk-free interest rate | 3.50% | 3.84% | 4.73% |
| Expected dividend yield | 1.6% | 1.8% | 1.8% |
| Expected stock price volatility | 47% | 43% | 38% |
| Expected option life | 5 yrs | 5 yrs | 6 yrs |

The assumptions were used for these calculations only and do not necessarily represent an indication of Management's expectations of future developments.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected share price volatility.

The Philips employee share options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

A summary of the status of the Philips share options granted to Company employees as of September 28, 2006 and December 31, 2005 and changes during the periods then ended is presented below:

## Fixed option plans

| | As of December 31, 2005 | | As of September 28, 2006 | |
|---|---|---|---|---|
| | shares | weighted average exercise | shares | weighted average exercise |
| | | (price in EUR) | | (price in EUR) |
| Outstanding at the beginning of the period | 4,472,773 | 29.72 | 4,640,812 | 28.17 |
| Granted | 496,799 | 15.25 | 816,150 | 26.27 |
| Exercised | 32,750 | 15.71 | (111,653) | 16.85 |
| Forfeited | (361,510) | 28.44 | (74,972) | 44.05 |
| Outstanding at the end of the period | 4,640,812 | 28.17 | 5,270,337 | 27.89 |
| Weighted average fair value of options granted during the period in EUR | 6.99 | | 9.74 | |
| | | (price in USD) | | |
| Outstanding at the beginning of the period | 6,788,973 | 28.45 | 6,237,756 | 28.19 |
| Granted | 608,867 | 25.13 | 592,254 | 32.23 |
| Exercised | (291,101) | 24.95 | (1,128,954) | 25.97 |
| Forfeited | (868,983) | 29.20 | (975,339) | 29.09 |
| Outstanding at the end of the period | 6,237,756 | 28.19 | 4,725,717 | 29.04 |
| Weighted average fair value of options granted during the period in USD | 9.28 | | 12.29 | |

## Variable plans

| | As of December 31, 2005 | | As of September 28, 2006 | |
|---|---|---|---|---|
| | shares | weighted average exercise | shares | weighted average exercise |
| | | (price in EUR) | | (price in EUR) |
| Outstanding at the beginning of the period | 892,677 | 34.62 | 790,664 | 34.43 |
| Granted | (53,475) | 36.71 | - | - |
| Exercised | - | - | - | - |
| Forfeited | (48,538) | 35.38 | (48,993) | 38.67 |
| Outstanding at the end of the period | 790,664 | 34.43 | 741,671 | 34.15 |
| | | (price in USD) | | |
| Outstanding at the beginning of the period | 1,405,074 | 32.67 | 1,121,780 | 32.79 |
| Granted | (13,400) | 31.56 | - | - |
| Exercised | (127,520) | 25.54 | (202,766) | 25.78 |
| Forfeited | (142,374) | 38.26 | (184,906) | 35.87 |
| Outstanding at the end of the period | 1,121,780 | 32.79 | 734,108 | 33.95 |

Transfers of employees from and to other Philips businesses are reflected in the table above.

A summary of the status of the Philips restricted share rights granted to Company employees as of the period and changes during the period is presented below:

### Restricted share rights*

| | As of December 31, 2005 | | As of September 28, 2006 | |
|---|---|---|---|---|
| | EUR-denominated shares | USD-denominated shares | EUR-denominated shares | USD-denominated shares |
| Outstanding at the beginning of the period | 387,116 | 512,563 | 448,341 | 470,566 |
| Granted | 225,714 | 214,437 | 278,169 | 197,418 |
| Vested/Issued | (137,738) | (198,648) | (218,900) | (227,669) |
| Forfeited | (26,751) | (57,786) | 8,322 | (59,404) |
| Outstanding at the end of the period | 448,341 | 470,566 | 515,932 | 380,911 |
| Weighted average fair value at grant date | EUR 19.08 | USD 24.40 | EUR 22.84 | USD 28.43 |

* Excludes incremental shares that may be received if shares awarded under the restricted share rights plan are not sold for a three-year period.

## 31 Fair value of financial assets and liabilities

The estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methods. The estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market exchange or the value that will ultimately be realized by the Company upon maturity or disposal. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts.

| | PREDECESSOR | | SUCCESSOR | |
|---|---|---|---|---|
| | As of December 31, 2005 | | As of December 31, 2006 | |
| | carrying amount | estimated fair value | carrying amount | estimated fair value |
| Assets; | | | | |
| Cash and cash equivalents | 110 | 110 | 939 | 939 |
| Accounts receivable – current | 589 | 589 | 563 | 563 |
| Other financial assets | 7 | 7 | 12 | 12 |
| Derivative instruments – assets | 9 | 9 | 8 | 8 |
| Liabilities: | | | | |
| Accounts payable | (470) | (470) | (489) | (489) |
| Debt | (371) | (371) | (4,449) | (4,560) |
| Loans with Philips companies | (1,112) | (1,112) | - | - |
| Derivative instruments – liabilities | (41) | (41) | (1) | (1) |

The following methods and assumptions were used to estimate the fair value of financial instruments:

### Cash and cash equivalents, accounts receivable and payable

The carrying amounts approximate fair value because of the short maturity of these instruments.

### Other financial assets

For other financial assets, fair value is based upon the quoted market prices.

### Debt

The fair value is estimated on the basis of the quoted market prices for certain issues, or on the basis of discounted cash flow analyses based upon the incremental borrowing rates for similar types of borrowing arrangements with comparable terms and maturities. Accrued interest is included under accounts payable and not within the carrying amount or estimated fair value of debt.

## 32 Other financial instruments, derivatives and currency risk

The Company does not purchase or hold financial derivative instruments for trading purposes. Assets and liabilities related to derivative instruments are disclosed in note 15 and note 20. Currency fluctuations may impact the Company's financial results. The Company has a limited structural currency mismatch between costs and revenues, as a proportion of its production, administration and research and development costs is denominated in euros, while a substantial proportion of its revenues is denominated in US dollars.

The Company's transactions are denominated in a variety of currencies. The Company uses financial instruments to reduce its exposure to the effects of currency fluctuations. The Company generally hedges foreign currency exposures in relation to transaction exposures, such as anticipated sales and purchases and receivables/payables resulting from such transactions. The Company generally uses forwards to hedge these exposures.

Changes in the fair value of foreign currency accounts receivable/payable as well as changes in the fair value of the hedges of accounts receivable/payable are reported in the statement of operations under cost of sales. The hedges related to anticipated transactions are recorded as cash flow hedges. The results from such hedges are deferred in equity.

For the predecessor period, hedges entered into by the Company were generally concluded by Philips. During the successor period and thereafter, NXP Management will perform its own assessment on the effectiveness of these hedging instruments.

Derivative instruments relate to

- hedged balance sheet items, with changes in the fair value of the instruments recorded in the income statement and
- cash flow hedges, with changes in the fair value recorded in accumulated other comprehensive income.

The derivative assets amounted to EUR 9 million and EUR 8 million, whereas derivative liabilities amounted to EUR 41 million and EUR 1 million as of December 31, 2005 and 2006, respectively, and are included in other current assets and accrued liabilities on the combined and consolidated balance sheets, respectively.

*Currency risk*

A substantial proportion of our cost base is incurred in euros, while most of our revenues are denominated in US dollars. Accordingly, our results of operations may be affected by changes in foreign currency exchange rates, particularly between the euro and the US dollar. A weakening US dollar against the euro during any reporting period will reduce EBIT of NXP.

It is NXP's policy that material transaction exposures are hedged. Accordingly, the Company's organizations identify and measure their exposures from material transactions denominated in other than their own functional currency.
We calculate our net exposure on a cash flow basis considering balance sheet items, actual orders received or made and anticipated revenues and expenses. Committed foreign currency exposures are required to be fully hedged using forward contracts. The net exposures related to anticipated transactions are hedged up to 70% for a maximum tenor of 24 months.
The translation exposures related to foreign currency denominated debt are not hedged.

The table below outlines the foreign currency transactions outstanding per December 31, 2006:

| In millions of euro equivalents | Aggregate Contract amount buy/ (sell) [1] | Fair value December 31, 2006 [1] | Weighted Average Tenor (in months) |
|---|---|---|---|
| Foreign currency forward contracts[1] | | | |
| Euro/ US dollar | 550 | 6.00 | 8.3 |
| US dollar/ Japanese Yen | (16) | 0.01 | 4 |
| Great Britain pound/ US dollar | 18 | 0.22 | 2 |
| US dollar/ Swedish kroner | (7) | (0.26 ) | 1.5 |
| US dollar/ Singapore dollar | (9) | 0.05 | 1.5 |
| US dollar/ Thailand baht | 7 | (0.13 ) | 1 |
| US dollar/ Malaysian Ringgit | 15 | (0.05 ) | 1 |
| Euro/ Great Britain pound | 17 | 0.10 | 1 |
| Euro/ Polish zloty | 29 | 0.15 | 1 |

[1] euro equivalent

The derivatives related to transactions are, for hedge accounting purposes, split into hedges of accounts receivable/payable and anticipated sales and purchases. Changes in the value of foreign currency accounts receivable/payable as well as the changes in fair value of the hedges of accounts receivable/payable are reported in the income statement under cost of sales.
Hedges related to anticipated transactions are accounted for as cash flow hedges. The results of such hedges are deferred in other comprehensive income within equity. Currently, a gain of EUR 6 million is deferred in equity as a result of these hedge transactions. The results from such hedges are released to income from operations when the related transactions affect the income statements.

*Interest rate risk*

NXP has significant outstanding debt, which creates an inherent interest rate risk. On October 12, 2006, NXP issued several series of notes with maturities ranging from 7 to 9 years and a mix of floating and fixed rates. The euro and US dollar denominated notes represent 34% and 66% respectively of the total notes outstanding.

The following table summarizes the outstanding notes per December 31, 2006:

| | Principal amount * | Fixed/ floating | Current coupon rate | Maturity date |
|---|---|---|---|---|
| Senior Secured Notes | EUR 1,000 | Floating | 6.214 | 2013 |
| Senior Secured Notes | USD 1,535 | Floating | 8.118 | 2013 |
| Senior Secured Notes | USD 1,026 | Fixed | 7.875 | 2014 |
| Senior Notes | EUR 525 | Fixed | 8.625 | 2015 |
| Senior Notes | USD 1,250 | Fixed | 9.500 | 2015 |

* amount in millions

A sensitivity analysis shows that if interest rates were to increase instantaneously by 1% from the level of December 31, 2006, all other variables held constant, the annualized net interest expense would increase by EUR 15 million. This impact is based on the outstanding net debt position as per December 31, 2006.

## 33 Supplemental Guarantor Information

Certain of the wholly-owned subsidiaries of NXP provide joint and several unconditional guarantees of NXP's obligations under the notes issued in connection with the acquisition of NXP. Pursuant to Rule 3-10 of Regulation S-X of the Securities and Exchange Commission, the following combined and consolidated financial information of the guarantors and non-guarantors is provided in lieu of financial statements of such guarantor entities, and has been determined based on the assets, liabilities and operations of the entities which were included in the guarantor and non-guarantor subsidiaries of NXP at the Separation. For the predecessor periods, the financial information for Philips Semiconductors International B.V. (now NXP B.V.) have been included in the combined financial information of the guarantors as there were no significant assets, liabilities or operations of Philips Semiconductors International B.V. for any of the periods presented. For the successor period, a separate column has been provided for NXP B.V. (as parent).

### Supplemental consolidated statement of operations for the period September 29, 2006 through December 31, 2006

| (SUCCESSOR) | NXP B.V. | guarantors | non-guarantors | eliminations/ reclassifications | consolidated |
|---|---|---|---|---|---|
| Sales | - | 879 | 311 | - | 1,190 |
| Intercompany sales | - | 339 | 127 | (466) | - |
| Total sales | - | 1,218 | 438 | (466) | 1,190 |
| Cost of sales | (157) | (802) | (411) | 453 | (917) |
| *Gross margin* | (157) | 416 | 27 | (13) | 273 |
| Selling expenses | - | (68) | (21) | 1 | (88) |
| General and administrative expenses | (119) | (61) | (15) | 1 | (194) |
| Research and development expenses | - | (166) | (103) | 11 | (258) |
| Write-off of acquired in-process research and development | (515) | - | - | - | (515) |
| Other business income (loss) | (29) | (100) | 132 | - | 3 |
| *Income (loss) from operations* | (820) | 21 | 20 | - | (779) |
| Financial expense | (25) | (45) | (3) | - | (73) |
| Income subsidiaries | 4 | - | - | (4) | - |
| *Income (loss) before taxes* | (841) | (24) | 17 | (4) | (852) |
| Income tax benefit (expense) | 227 | 18 | (3) | - | 242 |
| *Income (loss) after taxes* | (614) | (6) | 14 | (4) | (610) |
| Results relating to unconsolidated companies | (2) | - | - | - | (2) |
| Minority interests | - | - | (4) | - | (4) |
| Net income (loss) | (616) | (6) | 10 | (4) | (616) |

### Supplemental combined statement of operations for the period January 1, 2006 through September 28, 2006

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Sales | 2,827 | 875 | - | 3,702 |
| Intercompany and sales to Philips companies | 704 | 567 | (1,203) | 68 |
| Total sales | 3,531 | 1,442 | (1,203) | 3,770 |
| Cost of sales | (2,206) | (1,299) | 1,174 | (2,331) |
| *Gross margin* | 1,325 | 143 | (29) | 1,439 |
| Selling expenses | (217) | (62) | 4 | (275) |
| General and administrative expenses | (243) | (64) | 1 | (306) |
| Research and development expenses | (475) | (286) | 24 | (737) |
| Other business income (loss) | (326) | 344 | - | 18 |
| *Income (loss) from operations* | 64 | 75 | - | 139 |
| Financial expense | (15) | (7) | - | (22) |
| *Income (loss) before taxes* | 49 | 68 | - | 117 |
| Income tax expense | (59) | (6) | - | (65) |
| *Income (loss) after taxes* | (10) | 62 | - | 52 |
| Results relating to unconsolidated companies | (26) | - | 29 | 3 |
| Minority interests | - | (50) | - | (50) |
| Net income (loss) | (36) | 12 | 29 | 5 |

## Supplemental combined statement of operations for the year ended December 31, 2005

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Sales | 3,625 | 990 | - | 4,615 |
| Intercompany and sales to Philips companies | 847 | 761 | (1,457) | 151 |
| Total sales | 4,472 | 1,751 | (1,457) | 4,766 |
| Cost of sales | (2,774) | (1,572) | 1,413 | (2,933) |
| *Gross margin* | 1,698 | 179 | (44) | 1,833 |
| Selling expenses | (274) | (39) | 9 | (304) |
| General and administrative expenses | (350) | (85) | - | (435) |
| Research and development expenses | (719) | (344) | 35 | (1,028) |
| Other business income (loss) | (356) | 392 | - | 36 |
| *Income (loss) from operations* | (1) | 103 | - | 102 |
| Financial expense | (51) | (12) | - | (63) |
| *Income (loss) before taxes* | (52) | 91 | - | 39 |
| Income tax expense | (69) | (32) | - | (101) |
| *Income (loss) after taxes* | (121) | 59 | - | (62) |
| Results relating to unconsolidated companies | (23) | - | 18 | (5) |
| Minority interests | - | (34) | - | (34) |
| Net income (loss) | (144) | 25 | 18 | (101) |

## Supplemental combined statement of operations for the year ended December 31, 2004

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Sales | 3,634 | 975 | - | 4,609 |
| Intercompany and sales to Philips companies | 846 | 681 | (1,313) | 214 |
| Total sales | 4,480 | 1,656 | (1,313) | 4,823 |
| Cost of sales | (2,714) | (1,521) | 1,280 | (2,955) |
| Gross margin | 1,766 | 135 | (33) | 1,868 |
| Selling expenses | (287) | (23) | 13 | (297) |
| General and administrative expenses | (417) | (20) | - | (437) |
| Research and development expenses | (705) | (294) | 20 | (979) |
| Other business income (loss) | (305) | 384 | - | 79 |
| Income (loss) from operations | 52 | 182 | - | 234 |
| Financial expense | (75) | (18) | - | (93) |
| Income (loss) before taxes | (23) | 164 | - | 141 |
| Income tax expense | (58) | (55) | - | (113) |
| Income (loss) after taxes | (81) | 109 | - | 28 |
| Results relating to unconsolidated companies | 26 | - | (14) | 12 |
| Minority interests | - | (26) | - | (26) |
| Net income (loss) | (55) | 83 | (14) | 14 |

## Supplemental condensed consolidated balance sheet at December 31, 2006

| (SUCCESSOR) | NXP B.V. | guarantors | non-guarantors | eliminations/ reclassifications | consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | 613 | 161 | 165 | - | 939 |
| Receivables | - | 371 | 192 | - | 563 |
| Intercompany accounts receivable | 39 | 472 | 202 | (713) | - |
| Inventories | - | 568 | 78 | - | 646 |
| Other current assets | 22 | 49 | 54 | - | 125 |
| Total current assets | 674 | 1,621 | 691 | (713) | 2,273 |
| Non-current assets: | | | | | |
| Investments in unconsolidated companies | 43 | 1 | - | - | 44 |
| Investments in affiliated companies | 2,407 | - | - | (2,407) | - |
| Other non-current financial assets | - | 8 | 4 | - | 12 |
| Other non-current assets | 71 | 78 | 8 | - | 157 |
| Property, plant and equipment: | 394 | 1,135 | 755 | - | 2,284 |
| Intangible assets excluding goodwill | 3,012 | 46 | 7 | - | 3,065 |
| Goodwill | 2,032 | - | - | - | 2,032 |
| Total non-current assets | 7,959 | 1,268 | 774 | (2,407) | 7,594 |
| Total assets | 8,633 | 2,889 | 1,465 | (3,120) | 9,867 |
| Liabilities and Shareholder's equity | | | | | |
| Current liabilities: | | | | | |
| Accounts and notes payable | - | 391 | 98 | - | 489 |
| Intercompany accounts payable | 201 | 305 | 207 | (713) | - |
| Accrued liabilities | 85 | 254 | 146 | - | 485 |
| Short-term provisions | - | 36 | 18 | - | 54 |
| Other current liabilities | - | 25 | 20 | - | 45 |
| Short-term debt | - | - | 23 | - | 23 |
| Intercompany financing | - | 2,971 | 327 | (3,298) | - |
| Total current liabilities | 286 | 3,982 | 839 | (4,011) | 1,096 |
| Non-current liabilities: | | | | | |
| Long-term debt | 4,415 | 4 | 7 | - | 4,426 |
| Long-term provisions | 247 | 114 | 7 | - | 368 |
| Other non-current liabilities | - | 112 | 18 | - | 130 |
| Total non-current liabilities | 4,662 | 230 | 32 | - | 4,924 |
| Minority interests | - | - | 162 | - | 162 |
| Shareholder's equity | 3,685 | (1,323) | 432 | 891 | 3,685 |
| Total liabilities and Shareholder's equity | 8,633 | 2,889 | 1,465 | (3,120) | 9,867 |

## Supplemental condensed combined balance sheet at December 31, 2005

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | - | 110 | - | 110 |
| Receivables | 402 | 153 | - | 555 |
| Accounts receivable from Philips and intercompany | 200 | 106 | (272) | 34 |
| Inventories | 589 | 107 | - | 696 |
| Other current assets | 57 | 49 | - | 106 |
| Total current assets | 1,248 | 525 | (272) | 1,501 |
| Non-current assets: | | | | |
| Investments in unconsolidated companies | 53 | - | (5) | 48 |
| Other non-current financial assets | 7 | - | - | 7 |
| Other non-current assets | 80 | 42 | - | 122 |
| Property, plant and equipment | 1,195 | 861 | - | 2,056 |
| Intangible assets excluding goodwill | 56 | 2 | - | 58 |
| Goodwill | 182 | 31 | - | 213 |
| Total non-current assets | 1,573 | 936 | (5) | 2,504 |
| Total assets | 2,821 | 1,461 | (277) | 4,005 |
| Liabilities and Business' equity | | | | |
| Current liabilities: | | | | |
| Accounts and notes payable | 326 | 89 | - | 415 |
| Accounts payable to Philips companies and intercompany | 136 | 191 | (272) | 55 |
| Accrued liabilities | 416 | 132 | - | 548 |
| Short-term provisions | 46 | 7 | - | 53 |
| Other current liabilities | 35 | 20 | - | 55 |
| Short-term debt | 17 | 130 | - | 147 |
| Loans with Philips companies – current portion | 610 | - | - | 610 |
| Total current liabilities | 1,586 | 569 | (272) | 1,883 |
| Non-current liabilities: | | | | |
| Long-term debt | 145 | 79 | - | 224 |
| Loans with Philips companies – non-current portion | 502 | - | - | 502 |
| Long-term provisions | 62 | 26 | - | 88 |
| Other non-current liabilities | 9 | - | - | 9 |
| Total non-current liabilities | 718 | 105 | - | 823 |
| Minority interests | - | 173 | - | 173 |
| Business' equity | 517 | 614 | (5) | 1,126 |
| Total liabilities and Business' equity | 2,821 | 1,461 | (277) | 4,005 |

## Supplemental condensed consolidated statement of cash flows for the period September 29, 2006 through December 31, 2006

| (SUCCESSOR) | NXP B.V. | guarantors | non-guarantors | eliminations | consolidated |
|---|---|---|---|---|---|
| Cash flows from operating activities: | | | | | |
| Net income (loss) | (616) | (6) | 10 | (4) | (616) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | 660 | 80 | 71 | - | 811 |
| Net gain on sale of assets | 9 | (1) | (12) | - | (4) |
| Results relating to unconsolidated companies | 2 | - | - | - | 2 |
| Minority interests | - | - | 4 | - | 4 |
| Decrease (increase) in receivables and other current assets | 79 | 197 | (10) | - | 266 |
| Decrease in inventories | 130 | 23 | 15 | - | 168 |
| Increase (decrease) in accounts payable, accrued and other liabilities | 68 | (82) | 11 | - | (3) |
| Decrease (increase) intercompany current accounts | 162 | (101) | (61) | - | - |
| Increase in non-current receivables/other assets | (71) | (11) | - | - | (82) |
| Increase (decrease) in provisions | (214) | 11 | (3) | - | (206) |
| Other items | (57) | 5 | - | 4 | (48) |
| Net cash provided by operating activities | 152 | 115 | 25 | - | 292 |
| Cash flows from investing activities: | | | | | |
| Purchase of intangible assets | - | (3) | (2) | - | (5) |
| Capital expenditures on property, plant and equipment | - | (60) | (51) | - | (111) |
| Proceeds from disposals of property, plant and equipment | - | 6 | 16 | - | 22 |
| Purchase of other non-current financial assets | - | (1) | (1) | - | (2) |
| Purchase of interest in businesses | (48) | - | (45) | - | (93) |
| Proceeds from sale of interests in unconsolidated businesses | - | - | 5 | - | 5 |
| Net cash used for investing activities | (48) | (58) | (78) | - | (184) |
| Cash flows from financing activities: | | | | | |
| Net decrease in debt | 638 | 45 | 19 | - | 702 |
| Net changes in intercompany financing | 55 | (35) | (20) | - | - |
| Net changes in intercompany equity | (166) | 44 | 122 | - | - |
| Net cash provided by financing activities | 527 | 54 | 121 | - | 702 |
| Effect of changes in exchange rates on cash positions | (24) | (3) | (3) | - | (30) |
| Increase in cash and cash equivalents | 613 | 102 | 65 | - | 780 |
| Cash and cash equivalents at beginning of period | - | 59 | 100 | - | 159 |
| Cash and cash equivalents at end of period | 613 | 161 | 165 | - | 939 |

## Supplemental condensed combined statement of cash flows for the period January 1, 2006 through September 28, 2006

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income (loss) | (36) | 12 | 29 | 5 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 297 | 174 | - | 471 |
| Net gain on sale of assets | (6) | (1) | - | (7) |
| Results relating to unconsolidated companies | 26 | - | (29) | (3) |
| Minority interests | - | 50 | - | 50 |
| Increase in receivables and other current assets | (113) | (18) | - | (131) |
| Increase in inventories | (62) | (6) | - | (68) |
| Increase in accounts payable, accrued and other liabilities | 144 | 10 | - | 154 |
| Decrease (increase) in current accounts Phillips | (123) | 98 | - | (25) |
| Increase (decrease) in non-current receivables/other assets | (64) | 40 | | (24) |
| Increase (decrease) in provisions | 63 | (30) | - | 33 |
| Other items | 13 | - | - | 13 |
| Net cash provided by operating activities | 139 | 329 | - | 468 |
| Cash flows from investing activities: | | | | |
| Purchase of intangible assets | (10) | (2) | - | (12) |
| Capital expenditures on property, plant and equipment | (237) | (228) | - | (465) |
| Proceeds from disposals of property, plant and equipment | 26 | - | - | 26 |
| Purchase of other non-current financial assets | (1) | (2) | - | (3) |
| Purchase of interest in businesses | (3) | - | - | (3) |
| Proceeds from sale of interests in unconsolidated businesses | - | - | - | - |
| Net cash used for investing activities | (225) | (232) | - | (457) |
| Cash flows from financing activities: | | | | |
| Net decrease in debt | (149) | (173) | - | (322) |
| Net repayments of loans to Philips Companies | (497) | - | - | (497) |
| Net transactions with Philips | 794 | 73 | - | 867 |
| Net cash (used for) provided by financing activities | 148 | (100) | | 48 |
| Effect of changes in exchange rates on cash positions | (3) | (7) | - | (10) |
| Increase (decrease) in cash and cash equivalents | 59 | (10) | - | 49 |
| Cash and cash equivalents at beginning of period | - | 110 | - | 110 |
| Cash and cash equivalents at end of period | 59 | 100 | - | 159 |

## Supplemental condensed combined statement of cash flows for the year ended December 31, 2005

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income (loss) | (144) | 25 | 18 | (101) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 526 | 292 | - | 818 |
| Net gain on sale of assets | (15) | (2) | - | (17) |
| Results relating to unconsolidated companies | 23 | - | (18) | 5 |
| Minority interests | - | 34 | - | 34 |
| Increase in receivables and other current assets | (50) | (2) | - | (52) |
| (Increase) decrease in inventories | 65 | (36) | - | 29 |
| Increase (decrease) in accounts payable, accrued and other liabilities | 115 | (20) | - | 95 |
| Decrease (increase) in current accounts Phillips | 12 | 3 | - | 15 |
| Decrease (increase) in non-current receivables/other assets | (21) | - | - | (21) |
| Decrease in provisions | (26) | (5) | - | (31) |
| Other items | 16 | 2 | - | 18 |
| Net cash provided by operating activities | 501 | 291 | - | 792 |
| Cash flows from investing activities: | | | | |
| Purchase of intangible assets | (17) | (1) | - | (18) |
| Capital expenditures on property, plant and equipment | (263) | (107) | - | (370) |
| Proceeds from disposals of property, plant and equipment | 50 | - | - | 50 |
| Purchase of interest in businesses | (5) | (22) | - | (27) |
| Proceeds from sale of interests in unconsolidated businesses | 6 | 1 | - | 7 |
| Net cash used for investing activities | (229) | (129) | - | (358) |
| Cash flows from financing activities: | | | | |
| Net decrease in debt | (4) | (115) | - | (119) |
| Net repayments of loans to Philips Companies | (38) | (1) | - | (39) |
| Net transactions with Philips | (278) | 28 | - | (250) |
| Net cash used for financing activities | (320) | (88) | - | (408) |
| Effect of changes in exchange rates on cash positions | 1 | 8 | - | 9 |
| Increase (decrease) in cash and cash equivalents | (47) | 82 | - | 35 |
| Cash and cash equivalents at beginning of year | 47 | 28 | - | 75 |
| Cash and cash equivalents at end of year | - | 110 | - | 110 |

## Supplemental condensed combined statement of cash flows for the year ended December 31, 2004

| (PREDECESSOR) | guarantors | non-guarantors | eliminations | combined |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income (loss) | (55) | 83 | (14) | 14 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 587 | 262 | - | 849 |
| Net gain on sale of assets | (23) | 3 | - | (20) |
| Results relating to unconsolidated companies | (17) | - | 14 | (3) |
| Minority interests | - | 26 | - | 26 |
| Decrease (increase) in receivables and other current assets | 17 | (49) | - | (32) |
| Increase in inventories | (36) | (11) | - | (47) |
| Increase in accounts payable, accrued and other liabilities | 76 | 12 | - | 88 |
| Decrease (increase) in current accounts Phillips | (63) | 96 | | 33 |
| Decrease in non-current receivables/other assets | 17 | 21 | - | 38 |
| Increase in provisions | 4 | 12 | - | 16 |
| Other items | 15 | 1 | - | 16 |
| Net cash provided by operating activities | 522 | 456 | - | 978 |
| Cash flows from investing activities: | | | | |
| Purchase of intangible assets | (20) | (1) | - | (21) |
| Capital expenditures on property, plant and equipment | (323) | (318) | - | (641) |
| Proceeds from disposals of property, plant and equipment | 63 | - | - | 63 |
| Proceeds from sale of interests in unconsolidated businesses | 9 | - | - | 9 |
| Net cash used for investing activities | (271) | (319) | - | (590) |
| Cash flows from financing activities: | | | | |
| Net (decrease) increase in debt | 5 | (107) | - | (102) |
| Net borrowings (repayments) of loans to Philips Companies | 14 | (33) | - | (19) |
| Net transactions with Philips | (220) | (107) | - | (327) |
| Net cash used for financing activities | (201) | (247) | - | (448) |
| Effect of changes in consolidations on cash positions | - | 117 | - | 117 |
| Effect of changes in exchange rates on cash positions | (5) | (1) | - | (6) |
| Increase in cash and cash equivalents | 45 | 6 | - | 51 |
| Cash and cash equivalents at beginning of year | 2 | 22 | - | 24 |
| Cash and cash equivalents at end of year | 47 | 28 | - | 75 |

## 34 Subsequent events

On January 16, 2007, NXP announced it will not extend its current cooperation in the Crolles2 alliance beyond the initial term expiring at the end of 2007. NXP will work together with the alliance partners in 2007 to complete the current program and effectively manage the transition.

On February 8, 2007, NXP announced the agreement to acquire the Cellular Communications Business of Silicon Laboratories Inc. for an amount of USD 285 million in cash. NXP may pay up to an additional USD 65 million contingent upon the achievement of certain milestones in the next three years. This acquisition was completed on March 23, 2007.

On March 22, 2007, NXP announced the closure of the Böblingen operation in Germany and the reorganization of its back-end operations in the Philippines.

On April 27, NXP launched an offer to exchange its outstanding Fixed and Floating Rate Notes for identical notes registered under the U.S. Securities Act. NXP announced on June 19, 2007 the closing of this exchange. The exchanges have no effect on NXP's capitalization or debt outstanding.

On May 14, 2007 NXP and DSP Group, Inc. announced that they will combine their Cordless & VoIP terminals product lines within the DSP Group. The DSP Group will pay USD 270 million, consisting of USD 200 million in cash and USD 70 million in the issuance of DSP Group's common stock. The DSP Group has also agreed to a contingent cash payment of up to USD 75 million, based on future revenue performance. The transaction is expected to close in the third quarter of 2007, subject to closing conditions, including regulatory approvals.

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# Auditors' Reports

## Report of Independent Registered Public Accounting Firm

To the Board of Management of NXP B.V.

We have audited the accompanying combined balance sheet of NXP B.V. (formerly known as Philips Semiconductors International B.V.) and the semiconductor businesses of Philips (Predecessor) as of December 31, 2005, and the related combined statements of operations, changes in business' equity and comprehensive income (loss), and cash flows for the years ended December 31, 2004 and 2005 and for the period January 1, 2006 to September 28, 2006 (Predecessor periods), appearing on page 60 to 131. These combined financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of NXP B.V. (formerly known as Philips International Semiconductors B.V.) and the semiconductor businesses of Philips (Predecessor) as of December 31, 2005, and the combined results of their operations and their cash flows for the years ended December 31, 2004 and 2005 and for the period January 1, 2006 to September 28, 2006 (Predecessor periods) in conformity with US generally accepted accounting principles.

KPMG ACCOUNTANTS N.V.

Amstelveen, The Netherlands
March 22, 2007

## Report of Independent Registered Public Accounting Firm

To the Board of Management and Shareholders of NXP B.V.

We have audited the accompanying consolidated balance sheet of NXP B.V. and subsidiaries (the "Company") as of December 31, 2006 and the related consolidated statement of operations, shareholder's equity, and cash flows for the period from September 29, 2006 to December 31, 2006 (Successor period) as set out on page 60 to page 131. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The combined balance sheet as of December 31, 2005, and the related combined statements of operations, changes in business' equity and comprehensive income (loss), and cash flows for the years ended December 31, 2004 and 2005 and for the period January 1, 2006 to September 28, 2006 (Predecessor periods) were audited by other auditors whose report, dated March 22, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of NXP B.V. and subsidiaries as of December 31, 2006, and the results of their operations and their cash flows for the period from September 29, 2006 to December 31, 2006 (Successor period) in conformity with accounting principles generally accepted in the United States of America.

Deloitte Accountants B.V.
July 18, 2007

W.P.J. Keulers

# IFRS information

## Introduction

The consolidated financial statements of NXP B.V. ('the Company' or 'NXP') that are included in this section of the 2006 Annual Report are prepared on a basis consistent with International Financial Reporting Standards (IFRS) as endorsed by the European Union. For the Company, this is materially the same as IFRS as adopted by the International Accounting Standards Board (IASB). IFRS include both IFRS and International Accounting Standards (IAS).
For the IFRS accounting principles, reference is made to note 36 in this section.
These accounting principles are largely in conformity with the accounting policies that are applied in the Company's primary consolidated financial statements as prepared under United States Generally Accepted Accounting Principles ('US GAAP'), except for the application of purchase accounting for the acquisition of the Company. Under US GAAP accounting principles the purchase accounting effects were pushed down to NXP by KASLION, the parent company. However, under IFRS push-down accounting is not allowed and accordingly the purchase accounting effects are not in NXP's consolidated IFRS statements and notes.

The preparation of financial statements in conformity with IFRS requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The notes to the consolidated financial statements as prepared under US GAAP are an integral part of the financial statements as prepared under IFRS. Material differences based on differences between US GAAP and IFRS are disclosed separately in this section.

This section also contains a management commentary based on IFRS accounting policies.

This chapter of the 2006 Annual Report contains the management commentary and the audited consolidated financial statements including the notes thereon, all based on IFRS accounting policies. Effectively, NXP B.V. has been composed in its present form on September 29, 2006, whereas previously it was an empty dormant company within the Philips Group. Consequently, activities of the NXP Group started only on that date and the results of operations and cash flows therefore reflect only activities in the last quarter of 2006 and 2 days of September.

# Management commentary

## Key data

| In millions of euros | For the period January 1, – December 31, 2006 |
|---|---|
| Sales | 1,190 |
| Income from operations | 143 |
| *as a % of sales* | *12.0* |
| Financial income (expenses) | (73 ) |
| Income taxes | (17 ) |
| Results relating to unconsolidated companies | (2 ) |
| Income before minority interests | 51 |
| Minority interests | (4 ) |
| Net income attributable to shareholder | 47 |

## Sales per segment

| In millions of euros | For the period January 1, – December 31, 2006 |
|---|---|
| Mobile & Personal | 396 |
| Home | 212 |
| Automotive & Identification | 210 |
| MultiMarket Semiconductors | 328 |
| IC Manufacturing Operations | 28 |
| Corporate and Other | 16 |
| | 1,190 |

## Income (loss) from operations

| In millions of euros | For the period January 1, – December 31, 2006 |
|---|---|
| Mobile & Personal | 85 |
| Home | 3 |
| Automotive & Identification | 67 |
| MultiMarket Semiconductors | 83 |
| IC Manufacturing Operations | (21 ) |
| Corporate and Other | (74) |
| | 143 |

Sales in the fourth quarter of 2006 were EUR 1,190 million. The sales breakdown per operating business was Mobile & Personal (EUR 396 million), MultiMarket Semiconductors (EUR 328 million), Home (EUR 212 million) and Automotive & Identification (EUR 210 million). IC Manufacturing Operations had external sales of EUR 28 million. Towards the end of 2006 sales softened somewhat as the industry slowed down, primarily as a result of inventory corrections in the value chain.

Gross margin was EUR 428 million for the fourth quarter of 2006 or 36.0% as a percentage of sales. This includes the unfavorable effect of EUR 16 million for one-time items being restructuring costs, litigation costs and costs related to the legal disentanglement from Philips.

Selling expenses were EUR 88 million or 7.4% as a percentage of sales in the fourth quarter of 2006.

General and administrative expenses were EUR 75 million or 6.3% as a percentage of sales. This level includes the positive effects of our Business Renewal program, but was negatively impacted by one-time items for costs related to the legal disentanglement from Philips (EUR 14 million).

Research and development expenses were EUR 133 million or 11.2% as a percentage of sales in the fourth quarter of 2006. Our portfolio management and the corresponding exit of some product lines (amongst other DVD-R and Mobile Display Drivers) freed up resources which were redirected to our key battle areas. Total capitalization of development intangible assets is EUR 125 million. Other income was EUR 11 million for the fourth quarter in 2006 mainly related to the sale of certain fixed assets.

Income from operations was EUR 143 million or 12.0% as a percentage of sales in the fourth quarter of 2006.

The paragraph Management Discussion & Analysis in the US GAAP section of this Annual Report, to which you are referred, gives more extensive management commentary.

## IFRS Consolidated statement of operations of NXP B.V.

in millions of euros unless otherwise stated

| Note | | For the period January 1, 2006 - December 31, 2006 |
|---|---|---|
| | Sales | 1,172 |
| | Sales to Philips companies | 18 |
| | Total sales | 1,190 |
| | Cost of sales | (762) |
| | **Gross margin** | **428** |
| | Selling expenses | (88) |
| | General and administrative expenses | (75) |
| | Research and development expenses | (133) |
| | Other income | 11 |
| 8,40 | **Income from operations** | **143** |
| 9 | Financial income (expense) | (73) |
| | **Income before taxes** | **70** |
| 41 | Income tax (expense) benefit | (17) |
| | **Income after taxes** | **53** |
| 42 | Results relating to unconsolidated companies | (2) |
| | Income before minority interests | 51 |
| 12 | Minority interests | (4) |
| | **Net income attributable to shareholder** | **47** |

### Attribution of net income for the period:

| | |
|---|---|
| Net income attributable to shareholder | 47 |
| Net income attributable to minority interests | 4 |
| Net income for the period | 51 |

The accompanying notes are an integral part of these consolidated financial statements.

## IFRS Consolidated balance sheet of NXP B.V.

in millions of euros unless otherwise stated

### Assets

| Note | | | December 31, 2006 |
|---|---|---|---|
| | **Current assets** | | |
| | Cash and cash equivalents | | 939 |
| 38,43 | Receivables: | | |
| | -Accounts receivable – net | 557 | |
| | -Accounts receivable from Philips companies | 49 | |
| | -Other receivables | 13 | |
| | | | 619 |
| 14 | Inventories | | 646 |
| 44 | Other current assets | | 91 |
| | Total current assets | | 2,295 |
| | **Non-current assets** | | |
| 42 | Investments in unconsolidated companies | | 54 |
| 45 | Other non-current financial assets | | 12 |
| 38 | Other non-current asset | | 104 |
| 41 | Deferred tax assets | | 109 |
| 28,46 | Property, plant and equipment: | | |
| | -At cost | 2,042 | |
| | -Less accumulated depreciation | (146) | |
| | | | 1,896 |
| 47 | Intangible assets excluding goodwill: | | |
| | -At cost | 194 | |
| | -Less accumulated amortization | (6) | |
| | | | 188 |
| 48 | Goodwill | | 27 |
| | Total non-current assets | | 2,390 |
| | **Total** | | 4,685 |

The accompanying notes are an integral part of these combined and consolidated financial statements.

## Liabilities and equity

| Note | | December 31, 2006 | |
|---|---|---|---|
| | **Current liabilities** | | |
| 38 | Accounts payable: | | |
| | -Trade creditors | 446 | |
| | -Accounts payable to Philips companies | 43 | |
| | | | 489 |
| 49 | Accrued liabilities | | 426 |
| 23,29,50,51 | Short-term provisions | | 54 |
| 24 | Other current liabilities | | 45 |
| 25 | Short-term debt | | 23 |
| | Total current liabilities | | 1,037 |
| | **Non-current liabilities** | | |
| 28,52 | Long-term debt | | 4,344 |
| 23,29,50,51 | Long-term provisions | | 117 |
| 41 | Deferred tax liabilities | | 36 |
| 53 | Other non-current liabilities | | 130 |
| | Total non-current liabilities | | 4,627 |
| 28,29 | Commitments and contingent liabilities | | |
| | **Equity** | | |
| 12 | Minority interests | | 162 |
| | Issued capital | - | |
| | Reserves | (1,141) | |
| | Shareholder's equity | | (1,141) |
| | Total equity | | (979) |
| | **Total** | | 4,685 |

## IFRS Consolidated statement of cash flows of NXP B.V.

in millions of euros unless otherwise stated

| | For the period January 1, 2006 - December 31, 2006 |
|---|---|
| *Cash flows from operating activities:* | |
| **Net income** | 47 |
| Minority interests | 4 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | |
| Depreciation and amortization | 152 |
| Net gain on sale of assets | (13) |
| Results relating to unconsolidated companies | 2 |
| *Changes in operating assets and liabilities:* | |
| (Increase) decrease in receivables and other current assets | 290 |
| (Increase) decrease in inventories | 38 |
| Increase (decrease) in accounts payable, accrued and other liabilities | 11 |
| Decrease (increase) in non-current receivables/ other assets | (106) |
| Increase (decrease) in provisions | 40 |
| Other items | (48) |
| **Net cash provided by operating activities** | 417 |
| *Cash flows from investing activities:* | |
| Purchase of intangible assets | (5) |
| Capital expenditures on development assets | (125) |
| Capital expenditures on property, plant and equipment | (111) |
| Proceeds from disposals of property, plant and equipment | 22 |
| Purchase of other non-current financial assets | (2) |
| Purchase of interest in businesses | (93) |
| Proceeds from sale of interests in unconsolidated businesses | 5 |
| **Net cash used for investing activities** | (309) |
| *Cash flows from financing activities:* | |
| Increase in short-term debt | 17 |
| Proceeds from bridge loan facility, net | 4,400 |
| Repayment of loan Philips, net of settlements | (3,704) |
| Principal payments on long-term debt (incl. bridge loan) | (4,540) |
| Proceeds from the issuance of notes | 4,529 |
| **Net cash provided by (used for) financing activities** | 702 |
| Effect of changes in exchange rates on cash positions | (30) |
| Increase in cash and cash equivalents | 780 |
| Cash and cash equivalents at beginning of period | 159 |
| **Cash and cash equivalents at end of period** | 939 |
| *Supplemental disclosures to consolidated statement of cash flows* | |
| **Cash paid (received) during the period for:** | |
| Interest paid | 19 |
| Interest received | 15 |
| Income taxes | |
| **Net gain on sale of assets:** | |
| Cash proceeds from the sale of assets | 27 |
| Book value of these assets | (14) |
| | 13 |

For a number of reasons, principally the effects of translation differences and consolidation changes, certain items in the statement of cash flows do not correspond to the differences between the balance sheet amounts for the respective items.

The accompanying notes are an integral part of these consolidated financial statements.

The amount of restricted cash included in cash and cash equivalents was EUR 120 million.

## IFRS Consolidated statement of changes in equity of NXP B.V.

in millions of euros unless otherwise stated

| | Common stock | Capital in excess of par value | Retained earnings | Other reserves | Total share-holder's equity | Minority interests | Total equity |
|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2006** | - | - | - | - | - | - | - |
| Consolidation changes | - | (1,184) | - | - | (1,184) | 208 | (976) |
| Net income | | | 47 | | 47 | | |
| Current period change | | | | (4) | (4) | | |
| Income tax on current period changes | | | | - | - | | |
| Total recognized income and expense | | | 47 | (4) | 43 | | |
| | - | (1,184) | 47 | (4) | (1,141) | 162 | (979) |
| **Balance as of December 31, 2006** | - | (1,184) | 47 | (4) | (1,141) | 162 | (979) |

## Changes in other reserves

in millions of euros unless otherwise stated

| | Currency translation difference | Change in fair value of cash flow hedges | Total other reserves |
|---|---|---|---|
| **Balance as of January 1, 2006** | - | - | - |
| Current period change | (10) | 6 | (4) |
| Income tax on current period changes | - | - | - |
| **Balance as of December 31, 2006** | (10) | 6 | (4) |

The accompanying notes are an integral part of these consolidated financial statements.

# Notes to the IFRS consolidated financial statements of NXP B.V.

All amounts in millions of euros unless otherwise stated

The reader is also referred to the notes to the consolidated financial statements based on US GAAP.

## 35 Background

On September 29, 2006, Koninklijke Philips Electronics N.V. ("Philips") sold 80.1% of its semiconductors businesses to a consortium of private equity investors (“Private Equity Consortium”) in a multi-step transaction. As part of this sale, Philips transferred these semiconductor businesses to NXP B.V. (“NXP”, formerly known as Philips Semiconductors International B.V. or “the Company”), a wholly owned subsidiary of Philips, on September 28, 2006. This transaction is referred to as the "Separation". All of NXP’s issued and outstanding shares were then acquired by KASLION Acquisition B.V. ("KASLION"), which was formed as an acquisition vehicle by the Private Equity Consortium and Philips. This transaction is referred to as the "Acquisition". In order to fund the acquisition of NXP by KASLION, the Private Equity Consortium and Philips contributed cash to KASLION in exchange for 80.1% and 19.9%, respectively, of the total equity of KASLION.

The Company refers to the operations of NXP as NXP Semiconductors Group.

The consolidated financial statements include the accounts of NXP B.V. and subsidiaries.

### Reconciliation from IFRS to US GAAP

#### Reconciliation of net income from IFRS to US GAAP

| In millions of euros | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Net income as per the consolidated statement of income on an IFRS basis | 47 |
| Adjustments to reconcile to US GAAP: | |
| - Effect of capitalized product development cost | (125) |
| - Effect of amortization of product development cost | 1 |
| - Effect of differences between IFRS and US GAAP in purchase accounting | (798) |
| - Income tax effect on IFRS adjustments | 259 |
| Net loss as per the consolidated statement of income on a US GAAP basis | (616) |

### Reconciliation of shareholder's equity from IFRS to US GAAP

| In millions of euros | December 31, 2006 |
| --- | --- |
| Shareholder's equity as per the consolidated balance sheet on an IFRS basis | (1,141) |
| Adjustments to reconcile to US GAAP: | |
| - Permanent difference between IFRS and US GAAP in opening balance due to purchase accounting | 5,489 |
| - Effect of capitalized product development cost | (125) |
| - Effect of amortization of product development cost | 1 |
| - Effect of differences between IFRS and US GAAP in purchase accounting | (798) |
| - Income tax effect on IFRS adjustments | 259 |
| Shareholder's equity as per the consolidated balance sheet on a US GAAP basis | 3,685 |

## 36 IFRS Accounting policies and new accounting standards

The consolidated financial statements in this section have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union. This is for the Company materially the same as IFRS as adopted by the International Accounting Standards Board (IASB). IFRS include both IFRS and International Accounting Standards (IAS).
These are the Company's first consolidated financial statements under IFRS. The provisions of IFRS 1 "First-time Adoption of International Financial Reporting Standards" regarding prior period information have been applied.

Historical cost is used as the measurement basis unless otherwise indicated.
The principal accounting policies are set out below.

### Consolidation principles

The consolidated financial statements include the accounts of NXP B.V and all subsidiaries that are controlled by the Company and which is achieved by its power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Company applies IAS 27 'Consolidated and Separate Financial Statements' and Interpretation SIC 12 'Consolidation – Special Purpose Entities'. All intercompany balances and transactions have been eliminated in the consolidated financial statements. The minority interests are disclosed separately in the consolidated statement of operations as part of profit allocation and in the consolidated balance sheet as a separate component of equity, measured initially at the minority's proportion of the net fair value of the assets and liabilities.

### Investments in unconsolidated companies

Investments in companies in which the Company does not have the ability to directly or indirectly control the financial and operating decisions, but does possess the ability to exert significant influence, are accounted for using the equity method. Generally, in the absence of demonstrable proof of significant influence, it is presumed to exist if at least 20% of the voting stock is owned.

The Company's share of the net income of these associates is included in results relating to unconsolidated companies in the consolidated statement of operations. The Company recognizes an impairment loss when the recoverable amount of the investment is less than its carrying amount, in compliance with IAS 36 'Impairment of Assets'.
When its share of losses exceeds the carrying amount of an investment accounted for by the equity method, the carrying amount of that investment is reduced to zero and recognition of further losses is discontinued unless the Company has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee.

### Accounting for capital transactions of a subsidiary or an unconsolidated company

The Company recognizes in income dilution gains or losses arising from the sale or issuance of stock by a consolidated subsidiary that is included in the consolidated financial statements or an unconsolidated entity which is accounted for using the equity method of accounting in the consolidated statement of operations, unless the Company or the subsidiary either has reacquired or plans to reacquire such shares. In such instances, the result of the transaction will be recorded directly in equity.

The dilution gains or losses are presented in the consolidated statement of operations under other business income if they relate to subsidiaries that are included in the consolidated financial statements. Dilution gains and losses related to unconsolidated companies are presented under results relating to unconsolidated companies.

### Accounting for Alliance

A subsidiary of the Company is a participant in a jointly funded alliance (the 'Alliance') with two other semiconductors manufacturers in Crolles, France. The activities of the Alliance are the joint development of advanced process and assembly/packaging technology and the joint operation of a fabrication plant for the manufacturing of 300-millimeter wafers. The Alliance has its own governance structure to decide on all material decisions relating to the Alliance. Each of the three participants is equally represented in the governance structure. Upon its commencement each party contributed assets to the Alliance. The initial term of the Alliance expires December 31, 2007, and will be automatically extended until December 31, 2010 unless any of the parties serves written notice of termination prior to December 31, 2006. On January 16, 2007, the Company announced its intention to withdraw from the Crolles Alliance, effective December 31, 2007.

At the termination of the Alliance, the Company retains title to the capital assets that it contributed to the Alliance unless another participant of the Alliance exercises its option to purchase those assets at the higher of net book value or market value.

Under the Alliance arrangement, each participant is responsible for funding specific allocations of operations, research and development expenses, as well as related capital expenditures and output from the facility. Funding requirements are divided among the Company (31%) and the two other participants (31% and 38%), and are accounted for to ensure all expenses and capital expenditures are recorded in relation to the funding percentage.

The Company's interest in the Alliance has been accounted for in these consolidated financial statements as a contract or cost sharing arrangement.

Accordingly, the Company's share in the results of operation of the Alliance are recorded in the cost and expense caption in the accompanying consolidated statement of operations, and primarily consists of the Company's share of research and development expenses, pilot line manufacturing expenses and depreciation expense related to the Alliance's capital assets.
In the accompanying consolidated balance sheet the Company's share in the capital assets of the Alliance, for which it has title, is recorded in property, plant and equipment.

### Foreign currencies

The Company uses the euro as its functional and reporting currency. The financial statements of entities that use a functional currency other than the euro are translated into euros. Assets and liabilities are translated using the exchange rates on the respective balance sheet dates. Income and expense items in the income statement and cash flow statement are translated at weighted average exchange rates during the year. The resulting translation adjustments are recorded as a separate component of equity. Cumulative translation adjustments are recognized as income or expense upon partial or complete disposal or substantially complete liquidation of a foreign entity.
The functional currency of foreign entities is generally the local currency, unless the primary economic environment requires the use of another currency. When foreign entities conduct their business in economies considered to be highly inflationary, they record transactions in the Company's reporting currency instead of their local currency. Gains and losses arising from the translation or settlement of foreign currency-denominated transactions, monetary assets and liabilities into the functional currency are recognized in income in the period in which they arise. However, currency differences on intercompany loans that have the nature of a permanent investment are accounted for as translation differences as a separate component of equity.

### Derivative financial instruments

The Company uses derivative financial instruments principally in the management of its foreign currency risks and to a more limited extent for interest rate and commodity price risks. In compliance with IAS No. 39, 'Financial Instruments Recognition and Measurement' the Company measures all derivative financial instruments based on fair values derived from market prices of the instruments or from option pricing models, as appropriate.
Changes in the fair value of a derivative that is highly effective and designated and qualifies as a cash flow hedge, are recorded in a separate component of equity, until earnings are affected by the variability in cash flows of the designated hedged item.

The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is established that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur within a period of two months from the originally forecasted transaction date, the Company continues to carry the derivative on the consolidated balance sheet at its fair value, and gains and losses that were accumulated in equity are recognized immediately in the statement of operations. In all other situations in which hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the consolidated balance sheet, and recognizes any changes in its fair value in the statement of operations.

## Cash and cash equivalents

Cash and cash equivalents include all cash balances and short-term highly liquid investments with an original maturity of three months or less at acquisition that are readily convertible into known amounts of cash. It also includes restricted cash balances that cannot be freely repatriated. Cash and cash equivalents are stated at face value.

## Receivables

Trade accounts receivable are carried at the lower of amortized cost or the present value of estimated future cash flows. The present value of estimated future cash flows is determined through the use of allowances for uncollectible amounts. As soon as trade accounts receivable can no longer be collected in the normal way and are expected to result in a loss, they are designated as doubtful trade accounts receivable and valued at the expected collectible amounts. They are written off when they are deemed to be uncollectible because of bankruptcy or other forms of receivership of the debtors.
The allowance for the risk of non-collection of trade accounts receivable takes into account objective evidence about credit-risk concentration, collective debt risk based on average historical losses, and specific circumstances such as serious adverse economic conditions in a specific country or region.

## Inventories

Inventories are stated at the lower of cost or net realizable value, less advance payments on work in progress. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, taking into account the stage of completion. The cost of inventories is determined using the first-in, first-out (FIFO) method. Inventory is reduced for the estimated losses due to obsolescence. This reduction is determined for groups of products based on purchases in the recent past and/or expected future demand. Individual items of inventory that have been identified as obsolete are typically disposed of within a period of three months either by sale or by scrapping.

## Other non-current financial assets

Loans receivable are stated at amortized cost, less the related allowance for impaired loans receivable.

## Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and impairment losses. Assets constructed by the Company include direct costs, overheads and interest charges incurred for qualifying assets during the construction period. Government grants are deducted from the cost of the related asset. Depreciation is calculated using the straight-line method over the expected economic life of the asset. Depreciation of special tooling is generally also based on the straight-line method. Gains and losses on the sale of property, plant and equipment are included in other business income. Costs related to major maintenance activities are expensed in the period in which they are incurred unless leading to an extension of the original lifetime or capacity. Plant and equipment under capital leases are initially recorded at the lower of their fair value or the present value of minimum lease payments. These assets and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

Under the provisions of IFRIC Interpretation 1 'Changes in Existing Decommissioning, Restoration and Similar Liabilities' the Company recognizes the fair value of an asset retirement obligation in the period in which it is incurred, while an equal amount is capitalized as part of the carrying amount of the long-lived asset and subsequently depreciated over the life of the asset.

### Goodwill and impairment of goodwill

Under the provisions of IFRS 3 'Business Combinations' the Company initially determines the amount of goodwill, while under the provisions of IAS 36 'Impairment of Assets', goodwill is not amortized but tested for impairment annually in the third quarter or whenever impairment indicators require so. In accordance with IFRS 3 the Company identified its operating segments as its cash generating units. Cash flows on this level are substantially independent from other cash flows and this is the lowest level at which goodwill is monitored by management. A goodwill impairment loss is recognized in the statement of operations whenever and to the extent the carrying amount of goodwill of a cash generating unit exceeds the recoverable amount of that unit.

### Intangible assets

Intangible assets (other than goodwill) arising from acquisitions are amortized using the straight-line method over their estimated economic lives. Economic lives are evaluated every year. There are currently no intangible assets with indefinite lives. Patents and trademarks acquired from third parties are capitalized and amortized over their remaining useful lives.
Under IAS 38 'Intangible Assets' all research cost are expensed when incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalized as an intangible asset if the product or process is technically and commercially feasible and the Company has sufficient resources to complete development. The development expenditure capitalized includes the cost of materials, direct labor and an appropriate proportion of overheads. Other development expenditure and expenditure on research activities is recognized in the statement of operations as an expense as incurred. Capitalized development expenditure is stated at costs less accumulated amortization and impairment losses. Amortization of capitalized development expenditure is charged to the income statement on a straight-line basis over the estimated useful lives of the intangible assets. Costs relating to the development and purchase of software for internal use are capitalized and subsequently amortized over the estimated useful life of the software in accordance with IAS 38 'Intangible Assets'.

### Impairment or disposal of intangible assets other than goodwill and tangible fixed assets

The Company accounts for the impairment of intangible and tangible fixed assets in accordance with the provisions of IAS 36 'Impairment of Assets'. This Standard requires that assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is recognized and measured by a comparison of the carrying amount of an asset with the greater of its value in use and its fair value less cost to sell. Value in use is measured as the present value of future cash flows expected to be generated by the asset. If the carrying amount of an asset is not recoverable, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the recoverable amount. The review for impairment is carried out at the level where discrete cash flows occur that are independent of other cash flows.

For the IC Manufacturing Operations (IMO) segment, the review of impairment of long-lived assets is carried out on a Company-wide basis as IMO is the shared manufacturing base for the other business units with, for this purpose, no discrete cash flows that are largely independent of other cash flows. Assets held for sale are reported at the lower of the carrying amount or fair value, less cost to sell.

An impairment loss related to intangible assets other than goodwill, tangible fixed assets, inventories and within unconsolidated companies is reversed if and to the extent there has been a change in the estimates used to determine the recoverable amount. The loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. Reversal of impairment are recognized in the statement of operations.

### Provisions and accruals

The Company applies IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. The Company recognizes provisions for liabilities and probable losses that are a present obligation as of the balance sheet date and for which the amount is uncertain but can be reasonably estimated.
Provisions of a long-term nature are stated at present value when the amount and timing of related cash payments are fixed or reliably determinable. Short-term provisions are stated at face value.
The Company accrues for losses associated with environmental obligations when such losses are probable and reasonably estimable. Measurement of liabilities is based on current legal requirements and existing technology. Liabilities and expected insurance recoveries, if any, are recorded separately. The carrying amount of liabilities is regularly reviewed and adjusted for new facts or changes in law or technology. Insurance recoveries are recognized when they have been received or when receipt is virtually certain.

### Restructuring

The provision for restructuring relates to the estimated costs of initiated reorganizations that have been approved by the Board of Management, and which involve the realignment of certain parts of the industrial and commercial organization. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in restructuring provisions. IAS 37 requires that a liability be recognized for those costs only when the company has a detailed formal plan for the restructuring and has raised a valid expectation with those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

### Guarantees

The Company applies IAS 39 "Financial Instruments" and IAS 18 "Revenue" with respect to guarantee contracts. The Company recognizes a liability for the fair value of the obligation at the inception of a guarantee that is within the scope of the recognition criteria of these Standards.

### Debt and other liabilities

Debt and liabilities other than provisions are recognized initially at fair value and are subsequently stated at amortized cost. However, loans that are hedged under a fair value hedge are remeasured for the changes in the fair value that are attributable to the risk that is being hedged. Debt issue cost is not expensed immediately but are included in the amortized cost of the debt through the use of the effective interest method under IAS 39.

## Revenue recognition

The Company's revenues are primarily derived from made-to-order sales to Original Equipment Manufacturers ("OEM's") and similar customers. Furthermore, the Company's revenues are derived from sales to distributors.

The Company recognizes revenue in accordance with IAS 18 "Revenue" when persuasive evidence of an arrangement exists, delivery has occurred or the service has been provided, the sales price is fixed or determinable, and collection is reasonably assured, based on the terms and conditions of the sales contract. For made-to-order sales, these criteria are generally met at the time the product is shipped and delivered to the customer and title and risk have passed to the customer. Examples of delivery conditions typically meeting these criteria are 'Free on Board point of delivery' and 'Costs, Insurance Paid point of delivery'. Generally, the point of delivery is the customer's warehouse. Acceptance of the product by the customer is generally not contractually required, since, with made-to-order customers, manufacturing commences after design approval and delivery follows without further acceptance protocols. Payment terms used are those that are customary in the particular geographic market. When management has established that all aforementioned conditions for revenue recognition have been met and no further post-shipment obligations exist revenue is recognized.

For sales to distributors, the same recognition principles apply and similar terms and conditions as for sales to other customers are applied. However, for some distributors contractual arrangements are in place, which allow these distributors to return products if certain conditions are met. These conditions generally relate to the time period during which return is allowed and reflect customary conditions in the particular geographic market. Other return conditions relate to circumstances arising at the end of a product cycle, when certain distributors are permitted to return products purchased during a pre-defined period after the Company has announced a product's pending discontinuance. Long notice periods associated with these announcements generally prevent significant amounts of product from being returned, however. Repurchase agreements with OEM's or distributors are not entered into by the Company.

For sales where return rights exist, the Company determined, based on historical data, that only a very small percentage of the sales to distributors is actually returned. Currently the return percentage is less than 1%. Based on the historic data, a pro rata portion of the sales to these distributors is not recognized but deferred until the return period has lapsed or the other return conditions no longer apply.

Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. Shipping and handling costs billed to customers are recognized as revenues. Expenses incurred for shipping and handling costs of internal movements of goods are recorded as cost of sales. Shipping and handling costs related to sales to third parties are reported as selling expenses.

A provision for product warranty is made at the time of revenue recognition and reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to the sold products. In cases where the warranty period is extended and the customer has the option to purchase such an extension, which is subsequently billed separately to the customer, revenue recognition occurs on a straight-line basis over the contract period.

Royalty income, which is generally earned based upon a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis. Government grants, other than those relating to purchases of assets, are recognized as income as qualified expenditures are made.

### Income taxes

Income tax comprises current and deferred tax. Income tax is recognized in the statement of operations except to the extent that it relates to an item recognized directly within equity, in which case the related tax effect is recognized in equity as well.
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognized, using the balance sheet method, for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Measurement of deferred tax assets and liabilities is based upon the enacted or substantially enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets, including assets arising from loss carry forwards, are recognized if it is probable that the asset will be realized. Deferred tax assets are reviewed each reporting date and a valuation allowance is provided to the extent that it is no longer probable that the related tax benefit will be realized. Deferred tax assets and liabilities are not discounted.
Deferred tax liabilities for withholding taxes are recognized for subsidiaries in situations where the income is to be paid out as dividends in the foreseeable future, and for undistributed earnings of minority shareholdings.
Changes in tax rates are reflected in the period when the change has been enacted or substantively enacted by the balance sheet date.

### Employee Benefit Accounting

The Company accounts for the cost of pension plans and postretirement benefits other than pensions in accordance with IAS 19 'Employee Benefits'. Most of the Company's defined-benefit plans are funded with plan assets that have been segregated and restricted in a trust to provide for the pension benefits to which the Company has committed itself.
The Company employees participate in pension and other postretirement benefit plans that Philips has established in many countries. The costs of pension and other postretirement benefits and related assets and liabilities with respect to the Company employees participating in these plans have been allocated to the Company based upon actuarial computations, using the projected unit credit method.
Obligations for contributions to defined-contribution pension plans are recognized as an expense in the statement of operations as incurred.

### Share-based compensation

Immediately before the date of acquisition of NXP by KASLION, Philips announced all outstanding unvested stock options and restricted share rights related to employees of the semiconductor businesses of Philips would become fully vested and exercisable on October 16, 2006, which was recorded as part of the purchase price allocation (see note 30) in KASLION. For the period after Acquisition there is no share-based plan in place for employees and, as such, no new share-based compensation arrangements were granted to employees in the period from September 29, 2006 through December 31, 2006.

### Cash flow statements

Cash flow statements have been prepared using the indirect method in accordance with the requirements of IAS 7 'Cash Flow Statements'. Cash flows in foreign currencies have been translated into euros using the weighted average rates of exchange for the periods involved.
Cash flows from derivative instruments that are accounted for as fair value hedges or cash flow hedges are classified in the same category as the cash flows from the hedged items. Cash flows from derivative instruments for which hedge accounting has been discontinued are classified consistent with the nature of the instrument as from the date of discontinuance.

### Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements in order to conform to IFRS. Management bases its estimates and judgments on historical experience, current economic and industry conditions and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. If actual results differ significantly from management's estimates, there could be a material adverse effect on reported amounts of revenues and expenses during the reporting period, the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements.
Estimates significantly impact goodwill and other intangible assets acquired, impairments, liabilities from employee benefit plans, other provisions, tax and other contingencies. The fair values of acquired identifiable intangibles are based on an assessment of future cash flows. Impairment analysis of goodwill is performed annually and whenever a triggering event has occurred to determine whether the carrying value exceeds the recoverable amount. These analyses are based on estimates of future cash flows.

## New IFRS accounting standards

The IASB and its interpretation committee IFRIC issued several pronouncements, which will take effect as from 2007. The following are applicable to the Company.

In August 2005 the IASB issued the new Standard IFRS 7 Financial Instruments: Disclosures. The standard requires disclosure of the significance of financial instruments for an entity's position and performance, and qualitative and quantitative information on risks arising from financial instruments.

The Standard becomes effective from 2007 onwards. The effect on the Company's disclosure is expected to be limited because many of the required disclosures have already been made.

In November 2006, the IASB issued IFRS 8 "Operating Segments", mandatory as from 2009. The Company is in the process of reviewing the impact of this standard. Since this standard achieves convergence on the most important elements with US GAAP, the Company does not expect material impact from this standard on the financial outcomes of previous periods, since US GAAP constitutes the primary accounting basis for the Company. However, because segment reporting to management is based on US GAAP, segment disclosure under IFRS, which is under the new standard required to be prepared and presented "through the eyes of management" is likely to become identical to the US GAAP segment disclosure.

IFRC Interpretation 7 “Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies” will become mandatory as from 2007. The Company does not expect material impact from this interpretation.

IFRIC Interpretation 9 “Reassessment of Embedded Derivatives” will become effective for the Company as from 2007. The Company does not expect material impact from this interpretation.

IFRIC Interpretation 10 “Interim Financial Reporting and Impairment” prohibits impairments of goodwill and certain financial instruments in an interim report to be reversed in a later period. For the Company, the interpretation becomes effective as from 2007, but will not have an impact on outcomes presented in previous periods.

## 37 Information by Segment and Main Countries

The Company is structured in four market-oriented business units: Mobile & Personal, MultiMarket Semiconductors, Home and Automotive & Identification.

- Mobile & Personal delivers full systems solutions for cellular phones and personal entertainment devices.
- Home is a leading supplier of systems and components for the TV, PC TV and direct memory access segments of the consumer semiconductors market.
- Automotive & Identification has leading positions in car audio/radio, in-vehicle networking (IVN), car access and immobilization, tire pressure monitoring and magnetic sensors; Identification has leading positions in the radio frequency identification (RFID), near field communication (NFC) and eGovernment applications markets.
- MultiMarket Semiconductors provides a broad range of standard products (e.g. Bipolar, Power Discretes, Transistors & Diodes and Logic) and application specific standard products (e.g. Integrated Discretes, Interface Products and Microcontrollers).

The Company operates a shared manufacturing base, which is grouped in IC Manufacturing Operations, with the exception of manufacturing assets dedicated to MultiMarket Semiconductors products, which are reported as part of this segment.

Corporate and Other includes certain research and development activities, IP licensing, Emerging Products and special items not directly allocated to Business Units and/or IC Manufacturing Operations.

NXP Software (formerly Philips Software) included in Corporate and Other, specializes in innovative multimedia, security and connectivity solutions for manufacturers of mobile and portable equipment.

## Segments

| | sales | research and development expenses | income (loss) from operations | income (loss) from operations as a % of sales | results relating to unconsolidated companies |
|---|---|---|---|---|---|
| **For the period January 1, 2006 through December 31, 2006** | | | | | |
| Mobile & Personal | 396 | 26 | 85 | 21.5 | - |
| Home | 212 | 28 | 3 | 1.4 | - |
| Automotive & Identification | 210 | 12 | 67 | 31.9 | - |
| MultiMarket Semiconductors | 328 | 11 | 83 | 25.3 | - |
| IC Manufacturing Operations (*) | 28 | 11 | (21) | - [1] | - |
| Corporate and Other | 16 | 45 | (74) | - [1] | (2) |
| | 1,190 | 133 | 143 | 12.0 | (2) |

*) IC Manufacturing Operations supplied EUR 449 million to other segments, which have been eliminated in the above presentation.

[1] Not meaningful

## Segments

| | inventories | long-lived assets*) | total liabilities excl. debt | gross capital expenditures | amortization and depreciation of long-lived assets *) |
|---|---|---|---|---|---|
| **For the period January 1, 2006 through December 31, 2006** | | | | | |
| Mobile & Personal | 156 | 112 | 165 | 4 | 5 |
| Home | 84 | 56 | 86 | 2 | 2 |
| Automotive & Identification | 73 | 39 | 35 | 1 | 1 |
| MultiMarket Semiconductors | 166 | 262 | 115 | 14 | 23 |
| IC Manufacturing Operations | 167 | 1,137 | 515 | 65 | 88 |
| Corporate and Other | - | 505 | 277 | 25 | 33 |
| | 646 | 2,111 | 1,193 | 111 | 152 |

*) Long-lived assets include property, plant and equipment and intangible fixed assets.

## Goodwill assigned to segments

| For the period January 1, 2006 through December 31, 2006 | carrying value at January 1, 2006 | acquisitions | divestments | impairment | translation differences and other changes | carrying value at December 31, 2006 |
|---|---|---|---|---|---|---|
| Mobile & Personal | - | - | - | - | - | - |
| Home | - | - | - | - | - | - |
| Automotive & Identification | - | - | - | - | - | - |
| MultiMarket Semiconductors | - | - | - | - | - | - |
| IC Manufacturing Operations | - | 27 | - | - | - | 27 |
| Corporate and Other | - | - | - | - | - | - |
| | - | 27 | - | - | - | 27 |

## Main countries

| For the period January 1, 2006 through December 31, 2006 | Total sales |
|---|---|
| China | 254 |
| Netherlands | 181 |
| Taiwan | 100 |
| United States | 102 |
| Singapore | 150 |
| Germany | 70 |
| South Korea | 11 |
| Other countries | 322 |
| | 1,190 |

| For the period January 1, 2006 through December 31, 2006 | Total assets | gross capital expenditures |
|---|---|---|
| China | 306 | 6 |
| Netherlands | 1,473 | 16 |
| Taiwan | 439 | 2 |
| United States | 150 | 6 |
| Singapore | 519 | 20 |
| Germany | 365 | 13 |
| South Korea | 13 | - |
| Other countries | 1,316 | 48 |
| | 4,581 | 111 |

## 38 Related-party transactions

The Company entered into related-party transactions with the following company:
Advanced Semiconductor Manufacturing Corporation (ASMC) is an affiliate of the Company (see note 42).

Purchase of goods and services from ASMC for the period September 29, 2006 through December 31, 2006 amounted to EUR 5 million. The amount related to accounts payable to ASMC for the period September 29, 2006 through December 31, 2006 amounted to EUR 3 million.

In December 2006, selected members of our management purchased approximately 9.5 million depository receipts issued by the Stichting Management Co-Investment NXP, each of these receipts representing an economic interest in a common share of KASLION. These depository receipts have been purchased at fair market value and in the aggregate represent a beneficial interest in KASLION of 0.22%. The Company's parents are Philips, owning approximately 19.9%, and KASLION Holding B.V., owning approximately 80.1%. KASLION Holding B.V.'s ultimate parents are private equity investors.
The Company has a non-current receivable of EUR 104 million on its parent company KASLION with respect to recognized pension liabilities.

## 39 Acquisitions and divestments

In November 2006, the option to purchase additional outstanding stock of the Singapore-based wafer fabrication firm Systems on Silicon Manufacturing Company (SSMC) was fully exercised. An incremental 10.7% SSMC shares were acquired from the Economic Development Board (EDB), increasing the Company's equity interest to 61.2%, at cost of EUR 90 million paid in cash.

The total purchase price was allocated to property, plant and equipment (EUR 7 million), goodwill (EUR 27 million), other intangibles (EUR 11 million) and, as a consequence, a reduction in minority interests (EUR 45 million). Other intangibles fully consist of core technology.

There were no major divestments.

## 40 Income from operations

For information related to sales and income from operations on a geographical and business basis, see note 37.

### Sales composition

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Goods | 1,184 |
| Licenses | 6 |
| | 1,190 |

### Salaries and wages

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Salaries and wages | 337 |
| Pension and other postemployment costs | 26 |
| Other social security and similar charges: | |
| - Required by law | 45 |
| - Voluntary | 1 |
| | 409 |

Included in salaries and wages is nil relating to restructuring charges. Pension and postemployment costs are comprised of the costs of pension benefits, other postretirement benefits, and postemployment benefits, including obligatory severance.

Remuneration and pension charges relating to the members of the board of management amounted to EUR 700,000. During this period, no additional amount was awarded in the form of other compensation. When pension rights are granted to members of the board of management, necessary payments (if insured) and all necessary provisions are made in accordance with the applicable accounting principles. The members of our Supervisory Board, other than Sir Peter Bonfield, do not receive any cash compensation for their service on our Supervisory Board.

Refer to note 23, 50 and 51 to the financial statements for further information regarding these benefits.

### Depreciation and amortization

Depreciation of property, plant and equipment and amortization of intangibles are as follows:

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Depreciation of property, plant and equipment | 146 |
| Amortization of internal use software | 6 |
| Amortization of other intangible assets | - |
| | 152 |

Depreciation of property, plant and equipment includes an additional write-off in connection with the retirement of property, plant and equipment amounting to EUR 3 million.

No impairment charges relating to depreciation of property, plant and equipment were recorded. Depreciation of property, plant and equipment and amortization of software are primarily included in cost of sales.

### Foreign exchange differences

Included in cost of sales were foreign exchange differences amounting to a loss of EUR 7 million in the reporting period.

## Rent

Rent expenses amounted to EUR 20 million.

## Selling expenses

Selling expenses incurred totaled EUR 88 million.

The selling expenses mainly relate to the cost of the sales and marketing organization. This mainly consists of account management, marketing, first and second line support, and order desk.

## General and administrative expenses

General and administrative expenses include the costs related to management and staff departments in the corporate center, business units and business lines, amounting to EUR 75 million. The amortization expense of other intangible assets acquired in business combinations is included in this line item, except for amortization of in-process R&D and internal use software.

## Research and development expenses

Expenditures for research and development activities amounted to EUR 133 million.

For information related to research and development expenses on a segment basis, refer to note 37.

## Other income

Other income consists of the following:

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Results on disposal of properties | 13 |
| Remaining income | (2) |
| | 11 |

The result on disposal of fixed assets represents the gain on the sale of various properties.

Remaining income consists of various smaller items.

## 41 Income taxes

The tax expense on the income before income tax amounted to EUR 17 million.

There were no non reclaimable withholding taxes.

| | For the period January 1, 2006 - December 31, 2006 |
|---|---|
| The components of income tax benefit (expense) are as follows: | |
| Netherlands: | |
| Current taxes | - |
| Deferred taxes | (5) |
| | (5) |
| Foreign: | |
| Current taxes | (19) |
| Deferred taxes | 7 |
| | (12) |
| Income tax (expense) benefit | (17) |

The Company's operations are subject to income taxes in various foreign jurisdictions. Excluding certain tax incentives, the statutory income tax rates vary from 17.5% to 41%.

A reconciliation of the statutory income tax rate in the Netherlands as a percentage of income before taxes and the effective income tax rate is as follows:

| | For the period January 1, 2006 - December 31, 2006 |
|---|---|
| Statutory income tax in the Netherlands | 29.6 |
| Rate differential local statutory rates versus statutory rates of the Netherlands | (3.0) |
| Changes in the valuation allowance: | |
| – loss carryforwards not expected to be realized | 8.4 |
| – release and other changes | 2.3 |
| Non-taxable income | (9.6) |
| Non-tax-deductible expenses | 1.6 |
| Withholding and other taxes | 0.8 |
| Tax incentives and other | (5.5) |
| Effective tax rate | 24.6 |

## Deferred tax assets and liabilities

Deferred tax assets and liabilities relate to the following balance sheet captions:

| | Balance January 1, 2006 | Consolidation changes | Recognized in income | Recognized in equity | other | Balance December 31, 2006 |
|---|---|---|---|---|---|---|
| Intangible assets | - | - | (31) | - | - | (31) |
| Property, plant and equipment | - | (1) | (1) | - | - | (2) |
| Inventories | - | 12 | (5) | - | - | 7 |
| Other assets | - | 1 | (1) | - | - | - |
| Provisions: | - | | | | | |
| – Pensions | - | 14 | - | - | - | 14 |
| – Guarantees | - | - | 1 | - | - | 1 |
| – Termination benefits/ other postretirement benefits | - | 5 | 1 | - | 1 | 7 |
| – Other | - | 11 | (2) | - | - | 9 |
| Other liabilities | - | (5) | (3) | - | - | (8) |
| Tax loss carryforward (including tax credit carryforwards) | - | 31 | 44 | - | 1 | 76 |
| Net deferred tax assets (liabilities) | - | 68 | 3 | - | 2 | 73 |

In assessing the Company's ability to realize deferred tax assets, management considers whether it is probable that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income in the countries where the net operating losses were incurred. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is probable that the Company will realize all or some portion of the recognized benefits of these deductible differences. The unused tax losses as at December 31, 2006, amount to EUR 51 million.

At December 31, 2006, operating loss carryforwards expire as follows:

| Total | 2007 | 2008 | 2009 | 2010 | 2011 | 2012-2016 | later | unlimited |
|---|---|---|---|---|---|---|---|---|
| 496 | - | - | 22 | - | 19 | 243 | - | 212 |

The Company also has tax credit carryforwards of EUR 12 million, which are available to offset future tax, if any, and which expire as follows:

| Total | 2007 | 2008 | 2009 | 2010 | 2011 | 2012-2016 | later | unlimited |
|---|---|---|---|---|---|---|---|---|
| 12 | 1 | 5 | 4 | 1 | - | - | - | 1 |

Income tax payable, amounting to EUR 25 million as of December 31, 2006 includes amounts directly payable to tax authorities.

The amount of the unrecognized deferred income tax liability for temporary differences as of December 31, 2006, of EUR 11 million relates to unremitted earnings in foreign Group companies, which are considered to be permanently re-invested. Under current Dutch tax law, no additional taxes are payable. However, in certain jurisdictions, withholding taxes would be payable.

## 42 Investments in unconsolidated companies

### Results relating to unconsolidated companies

| | For the period January 1, 2006 – December 31 2006 |
|---|---|
| Company's participation in income (loss) | (2) |
| | (2) |

### Company's participation in income (loss)

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| ASMC | - |
| Others | (2) |
| | (2) |

The changes in investments in unconsolidated companies are as follows:

| | |
|---|---|
| Balance of equity method investments as of January 1, 2006 | - |
| Changes: | |
| Consolidation changes | 59 |
| Acquisitions/additions | 3 |
| Sales/repayments | (5) |
| Share in income (loss) | (2) |
| Translation and exchange rate differences | (1) |
| Balance of equity method investments as of December 31, 2006 | 54 |

Acquisitions relate to the shareholding in T3G. Sales/repayments related to the repayment of a loan by T3G.

The total carrying value of investments in unconsolidated companies is summarized as follows:

| | As of December 31, 2006 | |
|---|---|---|
| | Shareholding % | Amount |
| ASMC | | 47 |
| Others | | 7 |
| | | 54 |

## 43 Receivables

Accounts receivable are summarized as follows:

| | As of December 31, 2006 |
|---|---|
| Accounts receivable from third parties | 557 |
| Accounts receivable from unconsolidated companies | 3 |
| Less: allowance for doubtful accounts | (3) |
| | 557 |

## 44 Other current assets

Other current assets as of December 31, 2006, consist of derivative instrument assets of EUR 8 million and prepaid expenses of EUR 83 million.

## 45 Other non-current financial assets

Other non-current financial assets as of December 31, 2006 amounted to EUR 12 million, mainly consisting of long-term receivables from Laguna Ventures Inc. in The Philippines.

## 46 Property, plant and equipment

Property, plant and equipment consisted of:

| | total | land and buildings | machinery and installations | other equipment | prepayments and construction in progress | no longer productively employed |
|---|---|---|---|---|---|---|
| Balance as of January 1, 2006: | | | | | | |
| Cost | - | - | - | - | - | - |
| Accumulated depreciation | - | - | - | - | - | - |
| Book value | - | - | - | - | - | - |
| | | | | | | |
| Changes in book value: | | | | | | |
| Consolidation changes | 1,955 | 476 | 1,210 | 115 | 154 | - |
| Capital expenditures | 111 | - | - | - | 111 | - |
| Transfer assets put into use | - | 9 | 132 | 11 | (152) | - |
| Other additions | 7 | 3 | 4 | - | - | - |
| Retirements and sales | (12) | (6) | (6) | - | - | - |
| Depreciation | (143) | (9) | (125) | (9) | - | - |
| Write-downs and impairments | - | - | - | - | - | - |
| Translation differences | (22) | (6) | (15) | - | (1) | - |
| Total changes | 1,896 | 467 | 1,200 | 117 | 112 | - |
| | | | | | | |
| Balance as of December 31, 2006: | | | | | | |
| Cost | 2,042 | 478 | 1,326 | 126 | 112 | - |
| Accumulated depreciation | (146) | (11) | (126) | (9) | - | - |
| Book value | 1,896 | 467 | 1,200 | 117 | 112 | - |

Land with a book value of EUR 39 million is not depreciated.

Other additions are related to the incremental 10.7% acquisition of SSMC shares in November 2006. Refer to note 39.

The expected service lives as of December 31, 2006 are as follows:

| | |
|---|---|
| Buildings | from 12 to 50 years |
| Machinery and installations | from 2 to 7 years |
| Lease assets | from 3 to 10 years |
| Other equipment | from 3 to 10 years |

Capital expenditures include capitalized interest related to the construction in progress amounting to nil.

## 47 Intangible assets excluding goodwill

The changes in the period January 1, 2006 through December 31, 2006 were as follows:

| | total | other intangible assets | product development | software |
|---|---|---|---|---|
| Balance as of January 1, 2006: | | | | |
| Cost | - | - | - | - |
| Accumulated amortization | - | - | - | - |
| Book value | - | - | - | - |
| Changes in book value: | | | | |
| Consolidation changes | 54 | - | - | 54 |
| Acquisitions/additions | 140 | 10 | 125 | 5 |
| Amortization | (6) | - | - | (6) |
| Total changes | 188 | 10 | 125 | 53 |
| Balance as of December 31, 2006: | | | | |
| Cost | 194 | 10 | 125 | 59 |
| Accumulated amortization | (6) | - | - | (6) |
| Book value | 188 | 10 | 125 | 53 |

Other intangible assets including product development as of December 31 consist of:

| | As of December 31, 2006 | |
|---|---|---|
| | gross | Accumulated amortization |
| Marketing-related | - | - |
| Customer-related | - | - |
| Technology-based | 135 | - |
| | 135 | - |

The estimated amortization expense for these other intangible assets including product development as of December 31, 2006 for each of the five succeeding years are:

| | |
|---|---|
| 2007 | 19 |
| 2008 | 43 |
| 2009 | 42 |
| 2010 | 26 |
| 2011 | 1 |

All intangible assets, excluding goodwill, are subject to amortization and have no assumed residual value.

The estimated amortization expense for software as of December 31, 2006 for each of the five succeeding years are:

| | |
|---|---|
| 2007 | 18 |
| 2008 | 18 |
| 2009 | 17 |
| 2010 | - |
| 2011 | - |

The expected weighted average remaining life of other intangibles including product development is 3 years as of December 31, 2006. The expected weighted average remaining lifetime of software is 2 years as of December 31, 2006.

## 48 Goodwill

The changes in goodwill were as follows:

| | For the period January 1 - December 31, 2006 |
|---|---|
| Book value at begin of period | - |
| Changes in book value: | |
| Acquisitions | 27 |
| Translation differences | - |
| Book value at end of period | 27 |

Acquisitions in 2006 include goodwill related to the incremental 10.7% purchase of additional shares in SSMC. Refer to note 39. Please refer to note 37 for a specification of goodwill by segment.

## 49 Accrued Liabilities

Accrued liabilities are summarized as follows:

| | As of December 31, 2006 |
|---|---|
| Personnel-related costs: | |
| Salaries and wages | 114 |
| Accrued vacation entitlements | 56 |
| Other personnel-related costs | 53 |
| Utilities, rent and other | 30 |
| Income tax payable | 25 |
| Communication & IT costs | 20 |
| Distribution costs | 10 |
| Purchase-related costs | 21 |
| Interest accruals | 81 |
| Derivative instruments - liabilities | 1 |
| Liabilities for restructuring costs (refer to note 8) | 8 |
| Other accrued liabilities | 7 |
| | 426 |

## 50 Provisions

Provisions are summarized as follows:

| | As of December 31, 2006 long-term | short-term |
|---|---|---|
| Pensions for defined-benefit plans (refer to note 51) | 97 | 15 |
| Other postretirement benefits (refer to note 23) | - | 1 |
| Postemployment benefits and severance payments | 1 | 1 |
| Product warranty | - | 6 |
| Loss contingencies | 1 | 2 |
| Other provisions | 18 | 29 |
| Total | 117 | 54 |

The changes in total provisions are as follows:

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Beginning balance | - |
| Changes: | |
| Consolidation changes | 143 |
| Additions | 15 |
| Utilizations | (5) |
| Releases | - |
| Translation differences | (1) |
| Ending balance | 152 |

### Postemployment benefits and obligatory severance payments

The provision for postemployment benefits covers benefits provided to former or inactive employees after employment but before retirement, including salary continuation, supplemental unemployment benefits and disability-related benefits.

The provision for severance payments covers the Company's commitment to pay employees a lump sum upon the employee's dismissal or resignation. In the event that a former employee has passed away, in certain circumstances the Company pays a lump sum to the deceased employee's relatives.

### Product warranty

The provision for product warranty reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to products sold. The changes in the provision for product warranty are as follows:

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Beginning balance | - |
| Changes: | - |
| Consolidation changes | 7 |
| Additions | - |
| Utilizations | (1) |
| Releases | - |
| Ending balance | 6 |

### Loss contingencies (environmental remediation and product liability)

This provision includes expected losses recorded with respect to environmental remediation and product liability obligations which are deemed probable and reasonably estimatable. The changes in this provision are as follows:

| | For the period January 1, 2006 – December 31, 2006 |
|---|---|
| Beginning balance | - |
| Changes: | |
| Consolidation changes | 2 |
| Additions | 1 |
| Utilizations | - |
| Translation differences | - |
| Ending balance | 3 |

Philips has assumed obligations related to the environmental remediation that existed at the date of the Acquisition, primarily at certain closed sites in the United States. The Company has not incurred material environmental remediation obligations since the Acquisition. The remaining balance as of December 31, 2006 relates to minor product liability contingencies.

### Other provisions

Other provisions include provisions for employee jubilee funds totaling EUR 28 million as of December 31, 2006 (2005: EUR 22 million).

## 51 Pensions

The Company does not sponsor material postretirement benefits other than pensions. Our employees participate in employee pension plans in accordance with the legal requirements, customs and the local situation in the respective countries.

The majority of the employees in Europe are covered by defined- benefit pension plans. The benefits provided by these plans are based on employees' years of service and compensation levels. For other countries defined- contribution pension plans are more common. The measurement date for all defined- benefit pension plans is December 31. Contributions are made by the Company, as necessary, to provide assets sufficient to meet the benefits payable to defined-benefit pension plan participants.

These contributions are determined based upon various factors, including funded status, legal and tax considerations as well as local customs. NXP funds certain defined-benefit pension plans as claims are incurred.

The pension plans have been established by Philips. At the Separation, NXP disentangled the majority of its pension plans. Full disentanglement of remaining plans is expected to be completed before October 1, 2007.

For the Netherlands the disentanglement will be finalized one year after the Separation. During this one year period, the employees will participate in the Dutch Philips pension fund. It has been assumed that a transfer will take place and that the amount of plan assets transferred will equal the required reserves to offer equivalent benefits.

For pension plans in which only the Company's employees participate (the Company's dedicated plans), the related costs, assets and liabilities have been included in the consolidated balance sheets.

The majority of defined benefit plans can be typed as average wage plans.
NXP has adopted the corridor method where the excess of cumulative unrecognized actuarial gains and losses and corridor (10% of greater of pension assets and pension liabilities) will be recognised over average expected future service years.

The table below provides a summary of the changes in the pension benefit obligations and defined-benefit pensions plan assets for 2006, with respect to the Company's dedicated plans, and a reconciliation of the funded status of these plans to the amounts recognized in the consolidated balance sheet.

| | |
|---|---|
| **Projected benefit obligation** | |
| Projected benefit obligation at January 1, 2006 | - |
| Additions | 934 |
| Service cost | 16 |
| Interest cost | 10 |
| Actuarial (gains) and losses | - |
| Settlements | - |
| Benefits paid | (3) |
| Exchange rate differences | (1) |
| **Projected benefit obligation at end of year** | 956 |
| Present value of funded obligations at end of year | 844 |
| Present value of unfunded obligations at end of year | 112 |
| **Plan assets** | |
| Fair value of plan assets at January 1, 2006 | - |
| Additions | 701 |
| Expected return on plan assets | 9 |
| Actuarial (gains) losses on plan assets | - |
| Employer contributions | 16 |
| Benefits paid | (3) |
| Exchange rate differences | (1) |
| **Fair value of plan assets at end of year** | 722 |
| Funded status | (234) |
| Unrecognized net transition obligation | - |
| Unrecognized prior service cost | - |
| Unrecognized net loss | - |
| **Net balance** | (234) |
| **Classification of the net balances is as follows:** | |
| -Prepaid pension costs under other non-current assets | - |
| -Accrued pension costs under other non-current liabilities | (122) |
| -Provisions for pensions under provisions | (112) |
| Total | (234) |

The weighted average assumptions used to calculate the projected benefit obligations were as follows:

| | As of December 31, 2006 |
|---|---|
| Discount rate | 4.4% |
| Expected returns on plan assets | 5.3% |
| Expected rate of compensation increase | 3.1% |

The weighted-average assumptions used to calculate the net periodic pension cost were as follows:

| | For the period January 1, 2006 - December 31, 2006 |
|---|---|
| Discount rate | 4.4% |
| Expected returns on plan assets | 5.3% |
| Expected rate of compensation increase | 3.1% |

Expected returns per asset class are based on the assumption that asset valuations tend to return to their respective long-term equilibria. The Expected Return on Assets for any funded plan equals the average of the expected returns per asset class weigthed by their portfolio weights in accordance with the fund's strategic asset allocation.

The components of net periodic pension costs were as follows:

| | For the period January 1, 2006 - December 31, 2006 |
|---|---|
| Service cost | 16 |
| Interest cost on the projected benefit obligation | 10 |
| Expected return on plan assets | (9) |
| Net amortization of unrecognized net assets/liabilities | - |
| Net actuarial gain/loss recognized | - |
| Other | 1 |
| Net periodic cost | 18 |

The Company also sponsors defined-contribution plans and similar plans. The total cost of these plans amounted to EUR 8 million.

The Company expects to make cash contributions in relation to defined-benefit plans amounting to EUR 55 million in 2007.

## Plan assets

The actual and targeted pension plan asset allocation at December 31, 2006 is as follows:

| | As of December 31, 2006 |
|---|---|
| Asset category: | |
| Equity securities | 27% |
| Debt securities | 57% |
| Other | 16% |
| | 100% |

The investment objectives for the pension plan assets are designed to generate returns that, along with the future contributions, will enable the pension plans to meet their future obligations.

## 52 Long-term debt

| | range of interest rates | average rate of interest | amount outstanding 2006 | due in 2007 | due after 2007 | due after 2011 | average remaining term (in years) |
|---|---|---|---|---|---|---|---|
| Euro notes | 6.2-8.6 | 7.0 | 1,496 | - | 1,496 | 1,496 | 7.6 |
| USD notes | 7.9-9.5 | 8.5 | 2,837 | - | 2,837 | 2,837 | 7.8 |
| Bank borrowings | 4.1-4.8 | 4.4 | 1 | - | 1 | - | 1.5 |
| Liabilities arising from capital lease transactions | 5.9-6.0 | 5.9 | 8 | 2 | 6 | 2 | 5.8 |
| Other long-term debt | 2.1-2.1 | 2.1 | 4 | - | 4 | 3 | 4.6 |
| | | 8.0 | 4,346 | 2 | 4,344 | 4,338 | 7.7 |

The following amounts of long-term debt as of December 31, 2006 are due in the next 5 years:

| | |
|---|---|
| 2007 | 2 |
| 2008 | 3 |
| 2009 | 1 |
| 2010 | 1 |
| 2011 | 1 |
| | 8 |

Related to the Acquisition, NXP issued on October 12, 2006 several series of notes with maturities ranging from 7 to 9 years and a mix of floating and fixed rates. Several series are denominated in US dollar and several series are euro denominated. The euro and US dollar notes represent 34% and 66% respectively of the total notes outstanding. The series with tenors of 7 and 8 years are secured as described below; the series with a tenor of 9 years are unsecured.

**Euro Notes**

The Euro notes comprise of the following two series:

- a EUR 1,000 million aggregate principal amount of floating rate senior secured notes due 2013 with an interest rate of three-month EURIBOR plus 2.75%, except that the interest rate for the period beginning on the date these notes were offered, October 12, 2006 through January 14, 2007 the interest rate was 6.214%; and
- a EUR 525 million aggregate principal amount of 8.625% senior notes due 2015.

No redemptions on any of these series have been made; both series are fully outstanding at their original principal euro amount at year-end 2006. The unamortized portion of fees related to the issuance of these notes, amounting to EUR 29 million, has been deducted.

**USD Notes**

The USD notes comprise of the following three series:

- a USD 1,535 million aggregate principal amount of floating rate senior secured notes due 2013 with an interest rate of three-month LIBOR plus 2.75%, except that the interest rate for the period beginning on the date these notes were offered, October 12, 2006 through January 14, 2007 the interest rate was 8.118%; and
- a USD 1,026 million aggregate principal amount of 7.875% senior secured notes due 2014; and
- a USD 1,250 million aggregate principal amount of 9.5% senior notes due 2015.

No redemptions on any of these series have been made; all three series are fully outstanding at their original principal US dollar amount at year-end 2006. The unamortized portion of fees related to the issuance of these notes, amounting to EUR 53 million, has been deducted.

**Certain terms and Covenants of the Euro and USD Notes**

NXP is not required to make mandatory redemption payments or sinking fund payments with respect to the notes.
The indentures governing the notes contain covenants that, among other things, limit NXP's ability and that of restricted subsidiaries to incur additional indebtedness, create liens, pay dividends, redeem capital stock or make certain other restricted payments or investments; enter into agreements that restrict dividends from restricted subsidiaries; sell assets, including capital stock of restricted subsidiaries; engage in transactions with affiliates; and effect a consolidation or merger.

Certain portions of long-term and short-term debt as of December 31, 2006 in the amount of EUR 2,959 million have been secured by collateral on substantially all of the NXP's assets and of certain of its subsidiaries.

The notes are fully and unconditionally guaranteed jointly and severally, on a senior basis by certain of the Company's current and future material wholly-owned subsidiaries ("Guarantors").

Pursuant to various security documents related to the above mentioned secured notes and the EUR 500 million committed revolving credit facility, NXP and each Guarantor has granted first priority liens and security interests in, amongst others, the following, subject to the grant of further permitted collateral liens:

(a) all present and future shares of capital stock of (or other ownership or profit interests in) each of its present and future direct subsidiaries, other than SMST Unterstützungskasse GmbH, and material joint venture entities;

(b) all present and future intercompany debt of NXP and each Guarantor;

(c) all of the present and future property and assets, real and personal, of NXP, and each Guarantor, including, but not limited to, machinery and equipment, inventory and other goods, accounts receivable, owned real estate, leaseholds, fixtures, general intangibles, license rights, patents, trademarks, trade names, copyrights, chattel paper, insurance proceeds, contract rights, hedge agreements, documents, instruments, indemnification rights, tax refunds, but excluding cash and bank accounts; and

(d) all proceeds and products of the property and assets described above.

Notwithstanding the foregoing, certain assets may not be pledged (or the liens not perfected) in accordance with agreed security principles, including:

- if the cost of providing security is not proportionate to the benefit accruing to the holders;
- if providing such security requires consent of a third party and such consent cannot be obtained after the use of commercially reasonable efforts; and
- if providing such security would be prohibited by applicable law, general statutory limitations, financial assistance, corporate benefit, fraudulent preference, "thin capitalization" rules or similar matters or providing security would be outside the applicable pledgor's capacity or conflict with fiduciary duties of directors or cause material risk of personal or criminal liability after using commercially reasonable efforts to overcome such obstacles;
- if providing such security would have a material adverse effect (as reasonably determined in good faith by such subsidiary) on the ability of such subsidiary to conduct its operations and business in the ordinary course as otherwise permitted by the indenture; and
- if providing such security or perfecting liens thereon would require giving notice (i) in the case of receivables security, to customers or (ii) in the case of bank accounts, to the banks with whom the accounts are maintained. Such notice will only be provided after the secured notes are accelerated.

Subject to agreed security principles, if material property is acquired by NXP or a Guarantor that is not automatically subject to a perfected security interest under the security documents, then NXP or relevant Guarantor will within 60 days provide security over this property and deliver certain certificates and opinions in respect thereof as specified in the indenture governing the notes.

## Credit facilities

As of September 29, 2006, NXP entered into a senior secured revolving credit facility for an aggregate principal amount of EUR 500 million to finance the working capital requirements and general corporate purposes. This committed revolving credit facility has a tenor of 6 years and expires in 2012. All of the Guarantors of the secured notes described above are also guarantor of our obligations under this committed revolving credit facility and similar security as granted under the secured notes has been granted for the benefit of the lenders under this facility.

The amounts pledged as security for the notes issued by NXP as of December 31, 2006:

| | |
|---|---|
| Receivables | 371 |
| Inventories | 568 |
| Other current assets | 37 |
| Unconsolidated companies | 54 |
| Other non-current financial assets | 8 |
| Other non-current assets | 101 |
| Property, plant and equipment | 1,141 |

## 53 Other non-current liabilities

Other non-current liabilities are summarized as follows:

| | As of December 31, 2006 |
|---|---|
| Accrued pension costs | 122 |
| Asset retirement obligations | 4 |
| Liabilities for restructuring costs | 4 |
| | 130 |

## 54 Fair value of financial assets and liabilities

The estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methods. The estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market exchange or the value that will ultimately be realized by the Company upon maturity or disposal. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts.

| | As of December 31, 2006 | |
|---|---|---|
| | carrying amount | estimated fair value |
| **Assets;** | | |
| Cash and cash equivalents | 939 | 939 |
| Accounts receivable – current | 619 | 619 |
| Other financial assets | 12 | 12 |
| Derivative instruments – assets | 8 | 8 |
| **Liabilities:** | | |
| Accounts payable | (489) | (489) |
| Debt | (4,367) | (4,478) |
| Derivative instruments – liabilities | (1) | (1) |

The following methods and assumptions were used to estimate the fair value of financial instruments:

### Cash and cash equivalents, accounts receivable and payable

The carrying amounts approximate fair value because of the short maturity of these instruments.

### Other financial assets

For other financial assets, fair value is based upon the quoted market prices.

The fair value of the investment in unconsolidated companies has been derived from market quotations for ASMC. Other unconsolidated companies are not publicly quoted. Their fair value is assumed to be equal to their carrying amount.

### Debt

The fair value is estimated on the basis of the quoted market prices for certain issues, or on the basis of discounted cash flow analyses based upon the incremental borrowing rates for similar types of borrowing arrangements with comparable terms and maturities. Accrued interest is included under accounts payable and not within the carrying amount or estimated fair value of debt.

## 55 Other financial instruments, derivatives and currency risk

The Company does not purchase or hold financial derivative instruments for trading purposes. Assets and liabilities related to derivative instruments are disclosed in note 44 and note 49. Currency fluctuations may impact the Company's financial results. The Company has a limited structural currency mismatch between costs and revenues, as a proportion of its production, administration and research and development costs is denominated in euros, while a proportion of its revenues is denominated in US dollars.

The Company's transactions are denominated in a variety of currencies. The Company uses financial instruments to reduce its exposure to the effects of currency fluctuations. The Company generally hedges foreign currency exposures in relation to transaction exposures, such as anticipated sales and purchases and receivables/payables resulting from such transactions. The Company generally uses forwards to hedge these exposures.

Changes in the fair value of foreign currency accounts receivable/payable as well as changes in the fair value of the hedges of accounts receivable/payable are reported in the statement of operations under cost of sales. The hedges related to anticipated transactions are recorded as cash flow hedges. The results from such hedges are deferred in equity.

Derivative instruments relate to

- hedged balance sheet items, with changes in the fair value of the instruments recorded in the income statement and
- cash flow hedges, with changes in the fair value recorded in equity.

The derivative assets amounted to EUR 8 million, whereas derivative liabilities amounted to EUR 1 million as of December 31, 2006, and are included in other current assets and accrued liabilities on the consolidated balance sheet.

*Currency risk*

A substantial proportion of our cost base is incurred in euros, while most of our revenues are denominated in US dollars. Accordingly, our results of operations may be affected by changes in foreign currency exchange rates, particularly between the euro and the US dollar. A weakening US dollar against the euro during any reporting period will reduce EBIT of NXP.

It is NXP's policy that material transaction exposures are hedged. Accordingly, the Company's organizations identify and measure their exposures from material transactions denominated in other than their own functional currency.
We calculate our net exposure on a cash flow basis considering balance sheet items, actual orders received or made and anticipated revenues and expenses. Committed foreign currency exposures are required to be fully hedged using forward contracts. The net exposures related to anticipated transactions are hedged up to 70% for a maximum tenor of 24 months.
The translation exposures related to foreign currency denominated debt are not hedged.

The table below outlines the foreign currency transactions outstanding per December 31, 2006:

| In millions of euro equivalents | Aggregate Contract amount buy/ (sell) [1] | Fair value December 31, 2006 [1] | Weighted Average Tenor (in months) |
|---|---|---|---|
| Foreign currency forward contracts[1] | | | |
| Euro/ US dollar | 550 | 6.00 | 8.3 |
| US dollar/ Japanese Yen | (16) | 0.01 | 4 |
| Great Britain pound/ US dollar | 18 | 0.22 | 2 |
| US dollar/ Swedish kroner | (7) | (0.26 ) | 1.5 |
| US dollar/ Singapore dollar | (9) | 0.05 | 1.5 |
| US dollar/ Thailand baht | 7 | (0.13 ) | 1 |
| US dollar/ Malaysian Ringgit | 15 | (0.05 ) | 1 |
| Euro/ Great Britain pound | 17 | 0.10 | 1 |
| Euro/ Polish zloty | 29 | 0.15 | 1 |

[1] euro equivalent

The derivatives related to transactions are, for hedge accounting purposes, split into hedges of accounts receivable/payable and anticipated sales and purchases. Changes in the value of foreign currency accounts receivable/payable as well as the changes in fair value of the hedges of accounts receivable/payable are reported in the income statement under cost of sales.

Hedges related to anticipated transactions are accounted for as cash flow hedges. The results of such hedges are deferred in other comprehensive income within equity. Currently, a gain of EUR 6 million is deferred in equity as a result of these hedge transactions. The results from such hedges are released to income from operations when the related transactions affect the statement of operations.

*Interest rate risk*

NXP has significant outstanding debt, which creates an inherent interest rate risk. On October 12, 2006, NXP issued several series of notes with maturities ranging from 7 to 9 years and a mix of floating and fixed rates. The euro and US dollar denominated notes represent 34% and 66% respectively of the total notes outstanding.

The following table summarizes the outstanding notes per December 31, 2006:

| | Principal amount * | Fixed/ floating | Current coupon rate | Maturity date |
|---|---|---|---|---|
| Senior Secured Notes | EUR 1,000 | Floating | 6.214 | 2013 |
| Senior Secured Notes | USD 1,535 | Floating | 8.118 | 2013 |
| Senior Secured Notes | USD 1,026 | Fixed | 7.875 | 2014 |
| Senior Notes | EUR 525 | Fixed | 8.625 | 2015 |
| Senior Notes | USD 1,250 | Fixed | 9.500 | 2015 |

* amount in millions

A sensitivity analysis shows that if interest rates were to increase instantaneously by 1% from the level of December 31, 2006, all other variables held constant, the annualized net interest expense would increase by EUR 15 million. This impact is based on the outstanding net debt position as per December 31, 2006.

*Liquidity risk*

The rating of the Company's debt by major rating agencies may improve or deteriorate. As a result, the Company's borrowing capacity and financing costs may be impacted. The Company has various sources to mitigate such risk including a EUR 500 million committed revolving credit facility (maturing in 2012) and its cash on hands.

*Commodity price risk*

The Company is a purchaser of certain base metals, precious metals and energy used in the manufacturing process of our products. Currently the Company does not use financial derivative instruments to manage such exposure to fluctuations in commodity prices.

*Credit risk*

Credit risk represents the loss that would be recognized at the reporting date if counterparties failed to perform upon the agreed payment obligations. Credit risk is present within the trade receivables of the Company. Such exposure is reduced through ongoing credit evaluations of the financial conditions of our customers and by adjusting payment terms and credit limits when appropriate.

The Company invests available cash and cash equivalents with various financial institutions and is in that respect exposed to credit risk with these counterparties. The Company actively manages concentration risk on a daily basis adhering to a treasury management policy. Cash is invested and financial transactions are concluded where possible with financial institutions with a strong credit rating. As of December 31, 2006 most of the Company's cash was placed in short term deposits, with financial institutions with a rating of at least AA.

*Insurable risks*

Global insurance policies are in place to cover for possible losses resulting from various types of risks in the areas of property damage, business interruption, general and product liability, transport, directors and officers liability, employment practice liability, and criminal liability. To lower exposures and to avoid potential losses, the Company has a worldwide Risk Engineering program in place. The main focus in this program is on property damage and business interruption risks.

## 56 Subsequent events

On January 16, 2007, NXP announced it will not extend its current cooperation in the Crolles2 alliance beyond the initial term expiring at the end of 2007. NXP will work together with the alliance partners in 2007 to complete the current program and effectively manage the transition.

On February 8, 2007, NXP announced the agreement to acquire the Cellular Communications Business of Silicon Laboratories Inc. for an amount of USD 285 million in cash. NXP may pay up to an additional USD 65 million contingent upon the achievement of certain milestones in the next three years. This acquisition was completed on March 23, 2007.

On March 22, 2007, NXP announced the closure of the Böblingen operation in Germany and the reorganization of its back-end operations in the Philippines.

On April 27, NXP launched an offer to exchange its outstanding Fixed and Floating Rate Notes for identical notes registered under the U.S. Securities Act. NXP announced on June 19, 2007 the closing of this exchange. The exchanges have no effect on NXP's capitalization or debt outstanding.

On May 14, 2007 NXP and DSP Group, Inc. announced that they will combine their Cordless & VoIP terminals product lines within the DSP Group. The DSP Group will pay USD 270 million, consisting of USD 200 million in cash and USD 70 million in the issuance of DSP Group's common stock. The DSP Group has also agreed to a contingent cash payment of up to USD 75 million, based on future revenue performance. The transaction is expected to close in the third quarter of 2007, subject to closing conditions, including regulatory approvals.

# Auditor's Report

To the Board of Management and Shareholders of NXP B.V.

## Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements for the period started January 1, 2006 and ended December 31, 2006 as set out on page 135 to page 177 which are part of the financial statements of NXP B.V., Eindhoven, which comprise the consolidated balance sheet as at December 31, 2006, the profit and loss account for the period started January 1, 2006 and ended December 31, 2006, statement of changes in equity and cash flow statement for the period started January 1, 2006 and ended December 31, 2006 and a summary of significant accounting policies and other explanatory notes.

## Management's responsibility

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code, and for the preparation of the management discussion and analysis in accordance with Part 9 of Book 2 of the Netherlands Civil Code. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## Auditor's responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audit. We conducted our audit in accordance with Dutch law. This law requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of NPX B.V. as at December 31, 2006 and of its result and its cash flows for the period started January 1, 2006 and ended December 31, 2006 in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code.

## Report on other legal and regulatory requirements

Pursuant to the legal requirement under 2:393 sub 5 part e of the Netherlands Civil Code, we report, to the extent of our competence, that the management discussion and analysis is consistent with the consolidated financial statements as required by 2:391 sub 4 of the Netherlands Civil Code.

Deloitte Accountants B.V.
July 18, 2007

W.P.J. Keulers

## Balance sheet of NXP B.V.

in millions of euros unless otherwise stated

| | | December 31, 2005 | December 31, 2006 | |
|---|---|---|---|---|
| | **Assets** | | | |
| | Current assets: | | | |
| | Cash and cash equivalents | | 613 | |
| A | Other current assets | | 48 | |
| | | | | 661 |
| | Non-current assets: | | | |
| B | Other non current assets | | | 105 |
| C | Investments in affiliated companies | | | 2,793 |
| D | Goodwill | | | 26 |
| | Total | - | | 3,585 |
| | **Liabilities and shareholder's equity** | | | |
| | Current liabilities: | | | |
| E | Other current liabilities | | | 289 |
| | Non-current liabilities: | | | |
| | Pension provision | | | 19 |
| | Accrual for pensions | | | 85 |
| F | Long-term debt | | | 4,333 |
| G | Shareholder's equity: | | | |
| | Common shares, par value EUR 455 per share: | | | |
| | - Authorized: 200 shares | | | |
| | - Issued: 40 shares | | 0*) | |
| | Share premium | | | |
| | Revaluation reserves | | (4) | |
| | Other legal reserves | | | |
| | Retained earnings | | (1,184) | |
| | Net income | | 47 | |
| | Other reserves | | | |
| | | | | (1,141) |
| | Total | - | | 3,585 |

*) December 31, 2005 the legal predecessor of NXP B.V. was Philips Semiconductors International B.V., a "shelf" Company owned by Royal Philips Electronics N.V.
The figure of the share capital of EUR 18,200 is in the balance sheet rounded to zero.

## Statement of operations of NXP B.V.

in millions of euros unless otherwise stated

| | For the period September 29, 2006 – December 31, 2006 |
|---|---|
| Cost of sales | (1) |
| General and administrative expenses | (21) |
| Income (loss) from operations | (22) |
| Results from affiliated companies | 96 |
| Financial income (expenses) | (25) |
| Income before taxes | 49 |
| Income tax (expense) benefit | - |
| Income after taxes | 49 |
| Results related to unconsolidated companies | (2) |
| Net income attributable to shareholder | 47 |

## Statement of changes in equity of NXP B.V.

in millions of euros unless otherwise stated

| | Common stock | Revaluation reserves | Retained earnings | Net income | Total share-holder's equity |
|---|---|---|---|---|---|
| **Balance as of December 31, 2005** | - | - | - | - | - |
| Net income | | | | 47 | 47 |
| Net current period change | | (4)* | (1,184) | | (1,188) |
| Income tax on net current period change | | | | | |
| **Balance as of December 31, 2006** | - | (4) | (1,184) | 47 | (1,141) |

*) Revaluation reserves arise at the moment investments in affiliated companies change in value due to the changes in the underlying currencies.

## Accounting policies applied for Dutch law purposes

Dutch law allows companies that apply IFRS as adopted by the European Union in their consolidated financial statements to use the same accounting principles in the Company financial statements. Company financial statements that are based on this provision qualify as financial statements under Dutch law.

The financial statements of NXP B.V. (the 'Company') included in this section are prepared in accordance with IFRS accounting principles as used in the consolidated financial statements, in order to maintain the consistency between the figures in the consolidated financial statements and the financial statements of the Company. The same basis as applied for the Company has also been applied for the affiliated companies.

The accounting principles are explained in the section IFRS accounting policies of the chapter IFRS information of this Annual Report.

## Presentation of Company financial statements

The balance sheet presentation deviates from Dutch regulations and is more in line with common practice in the US in order to achieve optimal transparency for Dutch and US stakeholders.

Under this format, the order of presentation of assets and liabilities is based on the decreasing degree of liquidity, which is common practice in the US.

## Notes to the company financial statements

in millions of euros unless otherwise stated

### A Other current assets

| | December 31, 2006 |
|---|---|
| Interest receivable from affiliated companies | 39 |
| Prepayment/accrued income | 1 |
| Derivative instruments - assets | 8 |
| Total | 48 |

### B Other non-current assets

| | |
|---|---|
| Deferred tax receivable | 1 |
| Receivable KASLION | 104 |
| | 105 |

### C Investments in affiliated companies

The investments in affiliated companies are included in the balance sheet based on either their net asset value in accordance with the aforementioned accounting principles of the consolidated financial statements or at amortized cost.

| | Equity investments | loans | total |
|---|---|---|---|
| Balance as of December 31, 2005 | - | - | - |
| Changes: | | | |
| Acquisitions/additions | (591 ) | 3,417 | 2,826 |
| Sales/redemptions | | (173 ) | (173 ) |
| Amortizations | (3 ) | | (3 ) |
| After-tax income from affiliated companies | 96 | | 96 |
| Current account with affiliated companies | | 72 | 72 |
| Translation differences/other changes | (7 ) | (18 ) | (25 ) |
| Balance as of December 31, 2006 | (505 ) | 3,298 | 2,793 |

A list of subsidiaries and affiliated companies, prepared in accordance with the relevant legal requirements (Netherlands Civil Code, Book 2, Sections 379 and 414), is deposited at the office of the Commercial Register in Eindhoven, Netherlands.

### D Goodwill

The goodwill relates to the acquisition of an additional 10,7% shares in SSMC.

## E Other current liabilities

| | December 31, 2006 |
|---|---|
| Intercompany liabilities | 201 |
| Interest accruals | 78 |
| Derivative instruments - liabilities | 7 |
| Other accruals | 3 |
| Total | 289 |

## F Long-term debt

| | Range of interest rates | Average interest rate | Amount outstanding | Due in 1 year | Due after 1 year | Due after 5 years | Average remaining term (in years) |
|---|---|---|---|---|---|---|---|
| Senior secured FRN | 6.2 – 8.1 | 7.26 | 2,127 | - | 2,127 | 2,127 | 7.3 |
| Senior Secured Fixed Notes | 7.9 | 7.88 | 765 | - | 765 | 765 | 7.7 |
| Senior Fixed Notes | 8.6 – 9.5 | 9.20 | 1,441 | - | 1,441 | 1,441 | 8.8 |
| | | | 4,333 | - | 4,333 | 4,333 | |

## G Shareholder's equity

NXP B.V. has issued and paid up 40 ordinary shares of EUR 455 each or a nominal share capital of EUR 18,200. The shares are 100% owned by KASLION Acquisition B.V.

## H Net income

Net income in 2006 amounted to a profit of EUR 47 million. General and administrative expenses refer to the net expenses of the management and concern staff of NXP B.V.
The financial income and expenses are related to interest cost of bonds, interest income on loans to affiliated companies, interest income on surplus cash and exchange rate differences. For the remuneration of both the Board of Management and the Supervisory Board, please refer to note 40 of the IFRS consolidated financial statements.

## I Employees

The number of persons employed by the Company at year-end 2006 was 4 and included the members of the Board of Management. For the remuneration of the Board reference is made to the consolidated IFRS statements under note 40.

### J Obligations not appearing in the balance sheet

General guarantees as defined in Book 2, Section 403 of the Netherlands Civil Code has been given by NXP B.V. on behalf of NXP Software B.V. and NXP Netherlands B.V. in the Netherlands. The liabilities of these companies to third parties and unconsolidated companies totaled EUR 331million as of year-end 2006.

July 18, 2007
*The Supervisory Board*
*The Board of Management*

## Auditor's Report

To the Board of Management and Shareholders of NXP B.V.

### Report on the company financial statements

We have audited the accompanying company financial statements for the period started January 1, 2006 and ended December 31, 2006 as set out on page 180 until page 185 which are part of the financial statements of NXP B.V. which comprise the balance sheet as at December 31, 2006, the profit and loss account, statement of changes in equity and cash flow statement for the period started January 1, 2006 and ended December 31, 2006 and a summary of significant accounting policies and other explanatory notes.

### Management's responsibility

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An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the company financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the company financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the company financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the company financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

# Other information

## Opinion

In our opinion, the company financial statements give a true and fair view of the financial position of NXP B.V. as at December 31, 2006, and of its result and its cash flows for the period started January 1, 2006 and ended December 31, 2006 in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code.

## Report on other legal and regulatory requirements

Pursuant to the legal requirement under 2:393 sub 5 part e of the Netherlands Civil Code, we report, to the extent of our competence, that the management discussion and analysis is consistent with the company financial statements as required by 2:391 sub 4 of the Netherlands Civil Code.

Deloitte Accountants B.V.
July 18, 2007

W.P.J. Keulers

## Statutory rules concerning appropriation of profit

Article 35
35.1 Distribution of profits pursuant to this article shall be made following the adoption of the annual accounts which show that such distribution is allowed.
35.2 The profits shall be at the free disposal of the general meeting. In a tie vote regarding a proprosal to distribute or reserve profits, the profits concerned shall be reserved.
35.3 The company may only make distributions to the extent that its equity exceeds the total amount of its issued share capital and the reserves to be maintained pursuant to the law.
35.4 A loss may only be applied against reserves maintained pursuant to the law to the extent permitted by law.

## Proposal appropriation of profit for the financial year 2006

The profit incurred in the financial year 2006 will be added to the freely distributable reserves.

## Special statutory voting rights

There are no special statutory voting rights.

# Investor Information

## Corporate seat and head office

We were incorporated in The Netherlands as a Dutch private company with limited liability (*besloten vennootschap*) on December 21, 1990 as a wholly-owned subsidiary of Koninklijke Philips Electronics N.V. On September 29, 2006 we changed our name from Philips Semiconductors International B.V. to NXP B.V. Our corporate seat is in Eindhoven, The Netherlands, and the statutory list of all subsidiaries and affiliated companies, prepared in accordance with the relevant legal requirements (Netherlands Civil Code, Book 2, Sections 379 and 414), forms part of the notes to the consolidated financial statements and is deposited at the office of the Commercial Register in Eindhoven, Netherlands (file no. 17070622).
Our registered office is at High Tech Campus 60, 5656 AG, Eindhoven, The Netherlands, and our telephone number is +31 40 2745678.

## Investor Information

NXP is in contact with its investors via roadshows, one-on-one meetings, group meetings and broker conferences. The purpose of these meetings is to inform the market on the results, strategy and decisions made.

*Activities*

Detailed information for investors is available on our Investor Relations website http://www.nxp.com/investor/. Next to financial reports and various presentations, the site also provides a financial calendar, recent company news, a subscription possibility and contact information.

*Contacts*

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