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- 6 increased government pricing pressures;
- 7 interruptions in production
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- 9 litigation;
- 10 loss of key executives or other employees; and
- 11 adverse publicity and news coverage.

Any statements regarding earnings per share growth is not a profit forecast and should not be interpreted to mean that Roche's earnings or earnings per share for this year or any subsequent period will necessarily match or exceed the historical published earnings or earnings per share of Roche.



Changes in the Roche Financial Statements

Intangible assets - Accounting and impairment issues

Equity Compensation Plans - Income tax effects

Earnings Per Share



Disclosure changes

Few changes only – mainly pensions

'Employee benefits' IAS 19 (revised) – Notes 1 and 13

- Explanation and quantification of change in accounting policy (Note 1).
- Complete re-write of Note 13, giving new disclosures required and making the whole footnote more understandable and user-friendly.
- See presentation on Roche IR website (7 June 2006) for more details.

Business combinations / Discontinued businesses – Notes 10 and 11

- Reorganisation, including removal of old VFC and OTC transaction information.

Goodwill and Intangible assets – Notes 16 and 17

- Divisional split of goodwill and intangible assets.
- Details of intangible asset impairments.



Changes in the Roche Financial Statements

Intangible assets - Accounting and impairment issues

- What are the Roche Group's intangible assets.
- The impairment process.

Equity compensation plans – Income tax effects

Earnings Per Share



R&D – Current Accounting and Reporting

The existing accounting rules are not consistent

Internal R&D expenditure

- Internal research is expensed as incurred.
- Development costs can be capitalised, but only if a number of conditions (including economic benefits) are satisfied. Industry practice in Healthcare is to expense these.

In-licensing with alliance partners

- Assumption that cash paid for up-front/milestone represents the fair value of the assets acquired, even if (for example) early stage R&D: therefore capitalised.
- Tested for impairment in subsequent years. Amortisation commences on approval of marketable product.
- Difference to US GAAP, where such payments are typically expensed.

Business combinations

- Capitalised at fair value (according to third-party valuation). Intangibles arise mainly from marketed products and In-Process R&D (IPR&D). Surplus is goodwill.
- Difference to US GAAP, where acquired IPR&D is immediately expensed.

Roche Group's goodwill and intangible assets



Diagnostics ~60%, with Genentech most of rest

Net book value YE 2006 (CHF m)	Pharma	Diagnostics
<ul style="list-style-type: none"> • Goodwill Significant due to Roche's acquisition history (Genentech, Corange, Igen etc). 	1,869	4,045
<ul style="list-style-type: none"> • Intangible assets from acquisitions Significant due to Roche's acquisition history (Genentech, Corange, Chugai, Igen etc). 	1,291	2,524
<ul style="list-style-type: none"> • Other intangible assets Of growing significance due to alliance deals and acquisition of technology. 	1,345	309
Total	4,505	6,878

The impairment process



Two stage testing process

Two stage testing process required before each reporting event

- 1: Review for impairment triggers (e.g. reduced sales expectations, increased competition, termination of project, etc)
- 2: If any triggers identified, then compare book value of assets with economic value (discounted cash flow analysis). If necessary, write down book value to economic value

Full annual test for goodwill (and non-amortised intangibles)

- Full test regardless of any triggers at least once a year (i.e. go straight to stage 2)

Tested at cash-generating unit level

Goodwill	→	Sub-Divisional / Business Area
Intangible assets from Corange	→	Business Areas
Other intangible assets	→	Individual asset, usually based on patented product or technology



The impairment process

A growing issue

Accounting is not consistent

- The balance sheet values and expenses recorded depend on the origin of the R&D rather than its current nature and status.
- The timing of expenses does not necessarily match revenue recognition.

More intangibles will be capitalised

- Changes in IFRS effective from 2005 result in more intangible assets being capitalized from in-licensing arrangements, R&D alliances and acquisitions. Previously such expenditure was recorded as R&D expenses or capitalised as goodwill in the case of acquisitions.

More volatility in income

- Therefore impairment of intangible assets and related P&L volatility will become part of business-as-usual, due to both Roche businesses acquiring research or technology at an earlier stage, either through alliances or acquisitions.



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Equity Compensation Plans

Income taxes: main principles

Operating expense is fixed

- Operating expense is fixed at grant date and spread over vesting period, but ...

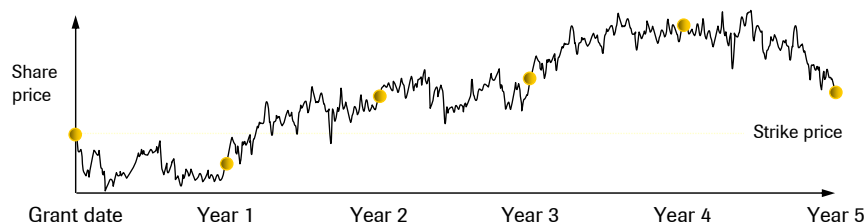
Tax benefit is variable

- Tax benefit variable (depending on market price) and booked until exercise
 - Tax benefit can be zero (if option out-of-the-money)
 - Tax benefit can include catch-up from prior periods
 - Overall cap on tax benefit (operating expense multiplied by tax rate)
 - Tax impacts last beyond vesting until exercise



Equity Compensation Plans

Income taxes: theoretical example



Operating expense	-100	-100	-100	-	-
Tax benefit	0	60	30	30	-40
Effective tax rate	0%	60%	30%	n/a	n/a

* Assumptions: 3 year cliff vesting plan, 40 % local tax rate, no exercises



Equity Compensation Plans

Income taxes: the story so far

Genentech equity compensation plans: tax effects

	FY '04 USD m	HY '05 USD m	FY '05 USD m	HY '06 USD m	FY '06 USD m
Operating profit	(105)	(105)	(245)	(208)	(407)
Tax benefit	29	61	99	23	41
Effective tax rate	27%	58%	40%	11%	10%



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Earnings Per Share



Earnings Per Share

Which EPS to use ?

Diluted EPS

- Best suited for reporting to shareholders on actual results.
 - Includes everything

Core EPS

- Best suited for reporting to analysts and investors on actual results and targets.
 - Focuses on the underlying business
 - Excludes historic irregular items (discontinuing businesses, exceptional items) and items that reduce comparability to peers (intangible asset amortisation)



Earnings Per Share

Modelling Diluted EPS

Minority interests

- Profits attributable to Genentech and Chugai minorities should be excluded from EPS.

Number of shares

- Increasing as own equity holdings reduce (FY'06 852m shares from FY'05 845m shares).

Dilutions

- Convertible debt
 - LYONs V (assuming call in 2007): approx 10m USD earnings, 2m shares (annualised)
- Genentech and Chugai stock options
 - growing earnings dilution (FY'06 104m CHF from FY'05 63m CHF)
- Roche stock options
 - growing per share dilution (FY'06 3m shares from FY'05 2m shares)



Earnings per share

Modelling Core EPS

The amortisation hurdle in a growth scenario

	Year 1	Year 2	% growth
Profit (CBBE*)	100	110	+10.0%
Amortisation of intangibles	10	10	0%
Core net income	110	120	+9.1%

* Continuing Business Before Exceptional items



Earnings Per Share

Hurdles for Core EPS to grow at sales rate

Profit from CBBE* must grow above sales to overcome dilution

- Amortisation/impairment of intangibles is not increasing at same rate as net income.
- Dilutive effects of Genentech stock options and other dilutive impacts.

To achieve this, simply bringing sales growth to the bottom line is not enough

- Operational efficiency must be further improved.
- Financial income and taxes must not dilute net income.
- Genentech and Chugai minorities should be compensated for.

Implications for 2007 (illustrative, based on situation at end of 2006)

- For Core EPS to increase by 10%, Profit from CBBE needs to increase at 11.5%.
- For Core EPS to increase by 15%, Profit from CBBE needs to increase at 17.8%.
- For Core EPS to increase by 20%, Profit from CBBE needs to increase at 24.0%

* Continuing Business Before Exceptional items



Earnings Per Share

In 2006, Core EPS growth exceeds sales, with increased operating efficiency more than compensating for dilution

