

Roche Holdings, Inc. Year End Report 2008

Management Report

Consolidated Financial Statements

for the year ended on December 31, 2008

Management Report

1. Review of the twelve months ended 2008

Important events

At the beginning of February 2008 the Roche Holdings, Inc. (RHI) Group completed the acquisition of Ventana Medical Systems, Inc. ('Ventana'), a publicly owned U.S. company based in Tucson, Arizona. Ventana develops, manufactures and markets instrument/reagent systems that automate slide preparation and staining in clinical histology and drug discovery laboratories. The total investment was \$3.5 billion, which has been funded by a net increase in related party debt of \$3.2 billion. Further details are given in Note 6 to the Annual Financial Statements.

On July 21, 2008 Roche made an offer to purchase all of the outstanding shares of Genentech for \$89.00 per share in cash and announced a reorganization of its U.S. pharmaceuticals business. This reorganization mainly relates to the closure of the Palo Alto site and the closure of manufacturing at the Nutley site, but also includes the transfer of the research operations from Palo Alto and other activities.

So far the financial crisis has not had a significant impact on the RHI Group's operations. The RHI Group continues to actively monitor its credit risk, with three major wholesalers accounting for approximately 70% of the RHI Group's \$1.8 billion trade receivables balance as in previous years.

Financial performance

In 2008 the RHI Group's total sales were \$17 billion, increasing 7%, despite the expected sharp decline of almost \$600 million in pandemic government and corporate Tamiflu sales. Excluding these the RHI Group's total sales increased by 11%. The growth continued to be driven in Pharmaceuticals by key products in the oncology portfolio. Additional growth drivers in Pharmaceuticals were Tamiflu (seasonal sales), Boniva in metabolism/bone and CellCept in transplantation. In Diagnostics sales growth drivers were the Professional Diagnostics and Applied Science businesses. Following the acquisition of Ventana at the beginning of February 2008, sales in the new Tissue Diagnostics business area were \$320 million.

The RHI Group's operating profit increased by 10% to \$5.9 billion with the corresponding margin increasing 0.8 percentage points to 35.0%. The Pharmaceuticals operating margin increased by 3.5 percentage points to 42.4%, despite significantly lower Tamiflu pandemic sales and increased investments in the strong development pipeline. The fall in the Diagnostics margin was generated by the impact of recent acquisitions, including one-time charges from Ventana, amortization of acquired intangible assets, investments to develop the sequencing and array businesses and molecular oncology tests and by strong competition in the US diabetes care market.

In the Pharmaceuticals Division there were two exceptional items: income of \$250 million from the settlement of Genentech's litigation with the City of Hope National Medical Center and expenses of \$225 million from the initial stages of Pharmaceuticals Division U.S. reorganization. The net impact of these on the RHI and divisional result is not significant.

During 2008 the RHI Group's treasury operations delivered a positive net financial income of \$35 million from transactions with third parties. The financing costs from related parties were \$411 million, an increase of \$240 million mainly arising from the additional related-party debt taken out to fund the acquisition of Ventana. The effective tax rate for the period decreased slightly by 0.2 percentage points to 38.8%.

Overall net income increased by \$123 million to \$3.4 billion, with the improvements in the underlying business outweighing the net effect of one-time items and the impacts of recent acquisitions.

The operating cash flow 2008 was \$5.4 billion. A total of \$3.5 billion was used to acquire full ownership of Ventana, which was funded by a net \$3.2 billion increase in related party debt. The total increase in cash was \$1.9 billion.

Financial position

The increase in total assets was mainly due to the acquisition of Ventana, with goodwill and intangible assets of \$2.8 billion added. The Ventana acquisition was financed by debt from related parties, which showed a net increase of

\$3.2 billion. There was a significant increase in cash and marketable securities of \$3.6 billion at Genentech. In addition, there was a decrease in legal provisions of \$0.8 billion following the resolution of the City of Hope litigation. In total the increase in net assets (equity) was \$2.3 billion. The increase of \$2.3 billion in equity consists mainly of \$3.4 billion of net income less the \$1.2 billion paid to increase the RHI Group's ownership in Ventana to 100%.

The RHI Group's defined benefit plans for pension and other post-employment benefits experienced actuarial losses of almost \$1 billion during 2008, mainly due to the fall in the fair value of assets in funded plans. The RHI Group's funded plans are under-funded by approximately \$1 billion and management currently estimates that it will make additional funding contributions of \$250 million during 2009.

2. Principal risks and uncertainties

Risks

The RHI Group is exposed to various financial risks arising from its underlying operations and corporate finance activities. The RHI Group's financial risk exposures are predominantly related to changes in interest rates, equity prices and to an extent, foreign exchange rates, as well as the creditworthiness and the solvency of the RHI Group's counterparties. The RHI Group's financial risk management is described in Note 30 to the Consolidated Financial Statements for the year ended December 31, 2008.

Uncertainties

The RHI Group's provisions and contingent liabilities are described in Note 24 to the Financial Statements ended December 31, 2008. In addition, key assumptions and sources of estimation uncertainty in the preparation of the financial statements are described in Note 1 to the Financial Statements for the year ended December 31, 2008.

The successful completion of the proposal to fully purchase Genentech and the further implementation of the Roche Pharmaceuticals reorganization would have a significant impact on the RHI Group's operations in the United States, including effects arising from the financing of the transaction.

The difficulties in the financial markets have not translated in any significant impact on the RHI Group's businesses so far. However, the developments are being closely monitored and if the situation continues or worsens through 2009, then the risk of negative impacts becomes more likely.

Various known and unknown risks, uncertainties and other factors could lead to substantial differences between the actual future results, financial situation development or performance of the RHI Group and the historical results given in the Management Report and the Financial Statements for the year ended 2008.

3. Responsibility statement

The consolidated financial statements of the RHI Group have been prepared in accordance with International Financial Reporting Standards (IFRS). They have been prepared using the historical cost convention except that, as disclosed in the accounting policies below, certain items, including derivatives and available-for-sale investments, are shown at fair value. They were approved for issue by the Board of Directors on January 28, 2009. The directors confirm that this Management Report includes a fair review of the information required.

Franz B. Humer
Chairman of the Board

Erich Hunziker
Vice Chairman of the Board

Severin Schwan
Member of the Board

Frank J. D'Angelo
Member of the Board

Frederick C. Kentz III
Member of the Board

David P. McDede
Member of the Board

Bruce Resnick
Member of the Board

Roche Holdings, Inc. Consolidated Financial Statements

Reference numbers indicate corresponding Notes to the Consolidated Financial Statements.

Roche Holdings, Inc. consolidated income statement for the year ended December 31, 2008

in millions of USD

	Pharmaceuticals	Diagnostics	Corporate	RHI Group
Sales ²	14,088	2,709	-	16,797
Royalties and other operating income ²	3,053	65	-	3,118
Cost of sales	(4,562)	(1,916)	-	(6,478)
Marketing and distribution	(2,247)	(716)	-	(2,963)
Research and development ²	(3,571)	(50)	-	(3,621)
General and administration	(811)	(178)	(4)	(993)
Operating profit before exceptional items ²	5,950	(86)	(4)	5,860
Major legal cases ²⁴	250	-	-	250
Changes in RHI Group organization ⁷	(225)	-	-	(225)
Operating profit ²	5,975	(86)	(4)	5,885
Associates ¹⁴				-
Financial income ⁴				422
Financing costs ⁴				(341)
Financing costs – related parties ³¹				(411)
Profit before taxes				5,555
Income taxes ⁵				(2,153)
Net income				3,402
Attributable to				
- Roche Holdings, Inc. shareholder				1,870
- Non-controlling interests				1,532

Roche Holdings, Inc. consolidated income statement for the year ended December 31, 2007

in millions of USD

	Pharmaceuticals	Diagnostics	Corporate	RHI Group
Sales ²	13,419	2,286	-	15,705
Royalties and other operating income ²	2,619	90	-	2,709
Cost of sales	(4,466)	(1,567)	-	(6,033)
Marketing and distribution	(2,313)	(529)	-	(2,842)
Research and development ²	(3,212)	4	-	(3,208)
General and administration	(826)	(143)	6	(963)
Operating profit ²	5,221	141	6	5,368
Associates ¹⁴				-
Financial income ⁴				566
Financing costs ⁴				(387)
Financing costs – related parties ³¹				(171)
Profit before taxes				5,376
Income taxes ⁵				(2,097)
Net income				3,279
Attributable to				
- Roche Holdings, Inc. shareholder				2,070
- Non-controlling interests				1,209

Roche Holdings, Inc. consolidated balance sheet *in millions of USD*

	December 31, 2008	December 31, 2007
Non-current assets		
Property, plant and equipment ¹¹	7,615	7,018
Goodwill ¹²	4,096	2,442
Intangible assets ¹³	3,344	1,954
Associates ¹⁴	-	-
Financial long-term assets ¹⁵	371	564
Financial long-term assets – related parties ³¹	95	95
Other long-term assets ¹⁵	322	380
Deferred income tax assets ⁵	1,224	857
Post-employment benefit assets ⁹	84	307
Total non-current assets	17,151	13,617
Current assets		
Inventories ¹⁶	2,006	2,207
Accounts receivable – trade ¹⁷	1,825	1,985
Accounts receivable – related parties ³¹	1,990	1,964
Current income tax assets ⁵	103	7
Other current assets ¹⁸	627	1,300
Marketable securities ¹⁹	6,382	4,637
Cash and cash equivalents ²⁰	2,910	1,042
Total current assets	15,843	13,142
Total assets	32,994	26,759
Non-current liabilities		
Long-term debt ²⁶	(2,418)	(2,877)
Long-term debt – related parties ^{26, 31}	(7,612)	(3,460)
Deferred income tax liabilities ⁵	(401)	(106)
Post-employment benefit liabilities ⁹	(1,332)	(614)
Provisions ²⁴	(275)	(250)
Other non-current liabilities ²⁵	(151)	(446)
Total non-current liabilities	(12,189)	(7,753)
Current liabilities		
Short-term debt ²⁶	(993)	(604)
Short-term debt – related parties ^{26, 31}	(205)	(1,204)
Current income tax liabilities ⁵	(584)	(411)
Provisions ²⁴	(427)	(1,073)
Accounts payable – trade and other ²¹	(526)	(654)
Accounts payable – related parties ³¹	(747)	(377)
Accrued and other current liabilities ²²	(3,132)	(2,829)
Total current liabilities	(6,614)	(7,152)
Total liabilities	(18,803)	(14,905)
Total net assets	14,191	11,854
Equity		
Capital and reserves attributable to Roche Holdings, Inc. shareholder ²⁷	7,200	6,589
Equity attributable to non-controlling interests ²⁸	6,991	5,265
Total equity	14,191	11,854

Roche Holdings, Inc. consolidated cash flow statement in millions of USD

	Year ended December 31,	
	2008	2007
Cash flows from operating activities		
Cash generated from operations ²⁹	7,445	6,972
(Increase) decrease in working capital	751	(1,362)
Payments made for defined benefit post-employment plans ⁹	(54)	(84)
Utilization of provisions ²⁴	(780)	(216)
Cash flows from operating activities, before income taxes paid	7,362	5,310
Income taxes paid	(1,908)	(1,913)
Total cash flows from operating activities	5,454	3,397
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,010)	(1,308)
Purchase of intangible assets	(475)	(512)
Disposal of property, plant and equipment	21	14
Disposal of intangible assets	83	298
Disposal of products	9	1
Business combinations ⁶	(2,373)	(1,287)
Interest received ²⁹	253	308
Interest received from related parties ³¹	37	37
Sales of marketable securities	2,011	1,798
Purchases of marketable securities	(3,024)	(2,963)
Other investing cash flows	(83)	(75)
Total cash flows from investing activities	(4,551)	(3,689)
Cash flows from financing activities		
Proceeds from issue of long-term debt instruments ²⁶	-	600
Proceeds from issue of related party debt ²⁶	4,427	2,464
Repayment and redemption of long-term debt instruments ²⁶	-	(1,590)
Repayment of related party debt ²⁶	(1,274)	(100)
Increase (decrease) in other long-term debt	(218)	(5)
Increase (decrease) in short-term borrowings	(134)	(6)
Change in ownership interest in subsidiaries		
- Ventana ⁶	(1,170)	-
Interest paid ²⁹	(118)	(140)
Interests paid to related parties ³¹	(421)	(204)
Exercises of equity-settled equity compensation plans ¹⁰	653	403
Genentech share repurchases ³	(780)	(1,344)
Total cash flows from financing activities	965	78
Increase (decrease) in cash and cash equivalents	1,868	(214)
Cash and cash equivalents at January 1	1,042	1,256
Cash and cash equivalents at December 31 ²⁰	2,910	1,042

Roche Holdings, Inc. consolidated statement of recognized income and expense *in millions of USD*

	Year ended December 31,	
	2008	2007
Available-for-sale investments		
- Valuation gains (losses) taken to equity ²⁷	(178)	(18)
- Transferred to income statement on sale or impairment ²⁷	19	16
Cash flow hedges		
- Gains (losses) taken to equity ²⁷	(52)	(38)
- Transferred to income statement ²⁷	77	(2)
Defined benefit post-employment plans		
- Actuarial gains (losses) ²⁷	(956)	142
Income taxes on items taken directly to or transferred from equity ²⁷	404	(51)
Net income recognized directly in equity	(686)	49
Net income recognized in income statement	3,402	3,279
Total recognized income and expense	2,716	3,328
Attributable to		
- Roche Holdings, Inc. shareholder ²⁷	1,216	2,122
- Non-controlling interests ²⁸	1,500	1,206
Total	2,716	3,328
Effect of changes in accounting policy attributable to		
- Roche Holdings, Inc. shareholder ¹	-	-
- Non-controlling interests ¹	-	-
Total	-	-

Roche Holdings, Inc. consolidated statement of changes in equity *in millions of USD*

	Roche Holdings, Inc. shareholder	Non-controlling interests	Total
Year ended December 31, 2007			
At January 1, 2007	4,711	4,316	9,027
Net income recognized directly in equity	52	(3)	49
Net income recognized in income statement	2,070	1,209	3,279
Total recognized income and expense	2,122	1,206	3,328
Dividends paid ^{27, 28}	-	-	-
Equity compensation plans ^{27, 28}	470	373	843
Genentech share repurchases ^{27, 28}	(749)	(595)	(1,344)
Changes in non-controlling interests ^{27, 28}	35	(35)	-
At December 31, 2007	6,589	5,265	11,854
Year ended December 31, 2008			
At January 1, 2008	6,589	5,265	11,854
Net income recognized directly in equity	(654)	(32)	(686)
Net income recognized in income statement	1,870	1,532	3,402
Total recognized income and expense	1,216	1,500	2,716
Ventana acquisition ⁶	-	291	291
Dividends paid ^{27, 28}	-	-	-
Equity compensation plans ^{27, 28}	751	529	1,280
Genentech share repurchases ^{27, 28}	(436)	(344)	(780)
Changes in ownership interests in subsidiaries ⁶	(879)	(291)	(1,170)
Changes in non-controlling interests ^{27, 28}	(41)	41	-
At December 31, 2008	7,200	6,991	14,191

Notes to the Roche Holdings, Inc. Consolidated Financial Statements

Reference numbers indicate corresponding Notes to the Consolidated Financial Statements.

1. Summary of significant accounting policies

Basis of preparation of the consolidated financial statements

These financial statements are the consolidated financial statements of Roche Holdings, Inc., a company incorporated in the State of Delaware, and its subsidiaries ("RHI" or "the RHI Group"). RHI is 100% indirectly owned by Roche Holding Ltd, a public company registered in Switzerland and parent company of the Roche Group. Roche Holdings, Inc. and its subsidiaries are therefore members of the Roche Group.

The consolidated financial statements of the RHI Group have been prepared in accordance with International Financial Reporting Standards (IFRS). They have been prepared using the historical cost convention except that, as disclosed in the accounting policies below, certain items, including derivatives and available-for-sale investments, are shown at fair value. They were approved for issue by the Board of Directors on January 28, 2009.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. If in the future such estimates and assumptions, which are based on management's best judgment at the date of the financial statements, deviate from the actual circumstances, the original estimates and assumptions will be modified as appropriate in the year in which the circumstances change.

Changes in accounting policies that arise from the application of new or revised standards and interpretations are applied retrospectively, unless otherwise specified in the transitional requirements of the particular standard or interpretation. Retrospective application requires that the results of the comparative period and the opening balances of that period are restated as if the new accounting policy had always been applied. In some cases the transitional requirements of the particular standard or interpretation specify that the changes are to be applied prospectively. Prospective application requires that the new accounting policy only be applied to the results of the current period and the comparative period is not restated. In addition comparatives have been reclassified or extended from the previously reported results to take into account any presentational changes.

Consolidation policy

These financial statements are the consolidated financial statements of Roche Holdings, Inc., a company incorporated in the State of Delaware, and its subsidiaries.

The subsidiaries are those companies controlled, directly or indirectly, by Roche Holdings, Inc., where control is defined as the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. This control is normally evidenced when Roche Holdings, Inc. owns, either directly or indirectly, more than 50% of the voting rights or currently exercisable potential voting rights of a company's share capital. Special Purpose Entities are consolidated where the substance of the relationship is that the Special Purpose Entity is controlled by the RHI Group. Companies acquired during the year are consolidated from the date on which control is transferred to the RHI Group, and subsidiaries to be divested are included up to the date on which control passes from the RHI Group. Inter-company balances, transactions and resulting unrealized income are eliminated in full. Changes in ownership interests in subsidiaries are accounted for as equity transactions if they occur after control has already been obtained and if they do not result in a loss of control.

Investments in associates are accounted for using the equity method. These are companies over which the RHI Group exercises, or has the power to exercise, significant influence, but which it does not control. This is normally evidenced when the RHI Group owns 20% or more of the voting rights or currently exercisable potential voting rights of the company. Balances and transactions with associates that result in unrealized income are eliminated to the extent of the RHI Group's interest in the associate. Interests in joint ventures are reported using the line-by-line proportionate consolidation method.

Segment reporting

The RHI Group's format for segment reporting is operating segments. The RHI Group operates in the United States of America ("U.S.") and does not have separately distinguishable geographical segments.

The determination of the RHI Group's operating segments is based on the organization units for which information is reported to the RHI Group's management. The RHI Group has two divisions, Pharmaceuticals and Diagnostics. Revenues are primarily generated from the sale of prescription pharmaceutical products and diagnostic instruments, reagents and consumables, respectively. Both divisions also derive revenue from the sale or licensing of products or technology to third parties. Within the Pharmaceuticals Division there are two sub-divisions, Roche Pharmaceuticals and Genentech. The two sub-divisions have separate management and reporting structures within the Pharmaceuticals Division and are considered separately reportable operating segments. Certain corporate activities that cannot be reasonably allocated to the other reportable business segments based on RHI's management and organizational structure are reported as 'Corporate'.

Transfer prices between operating segments are set on an arm's length basis. Operating assets and liabilities consist of property, plant and equipment, goodwill and intangible assets, trade receivables/payables, inventories and other assets and liabilities, such as provisions, which can be reasonably attributed to the reported operating segments. Non-operating assets and liabilities mainly include current and deferred income tax balances, post-employment benefit assets/liabilities and financial assets/liabilities such as cash, marketable securities, investments and debt.

Foreign currency translation

RHI and its subsidiaries use the U.S. dollar as the functional and presentation currency. Local transactions in other currencies are initially reported using the exchange rate at the date of the transaction. Gains and losses from the settlement of such transactions and gains and losses on translation of monetary assets and liabilities denominated in other currencies are included in income, except qualifying cash flow hedges, which are recorded in equity.

Revenues

Sales represent amounts received and receivable for goods supplied to customers after deducting trade discounts, cash discounts and volume rebates, and exclude value added taxes and other taxes directly linked to sales. Revenues from the sale of products are recognized upon transfer to the customer of significant risks and rewards. Trade discounts, cash discounts and volume rebates are recorded on an accrual basis consistent with the recognition of the related sales. Estimates of expected sales returns, chargebacks and other rebates, including Medicaid in the United States, are also deducted from sales and recorded as accrued liabilities or provisions or as a deduction from accounts receivable. Such estimates are based on analyses of existing contractual or legislatively mandated obligations, historical trends and RHI's experience. Other revenues are recorded as earned or as the services are performed. Where necessary, single transactions are split into separately identifiable components to reflect the substance of the transaction. Conversely, two or more transactions may be considered together for revenue recognition purposes, where the commercial effect cannot be understood without reference to the series of transactions as a whole.

Cost of sales

Cost of sales includes the corresponding direct production costs and related production overheads of goods sold and services rendered. Royalties, alliance and collaboration expenses, including all collaboration profit-sharing arrangements are also reported as part of cost of sales. Start-up costs between validation and the achievement of normal production capacity are expensed as incurred.

Research and development

In addition to its internal research and development activities, the RHI Group is also party to in-licensing and similar arrangements with its alliance partners. The RHI Group may also acquire in-process research and development assets, either through business combinations or through purchases of specific assets.

Internal research costs are charged against income as incurred. Internal development costs are capitalized as intangible assets only when there is an identifiable asset that can be completed and that will generate probable future economic benefits and when the cost of such an asset can be measured reliably. The RHI Group does not currently have any such internal development costs that qualify for capitalization as intangible assets. Internal development costs are therefore charged against income as incurred since the criteria for their recognition as an asset are not met.

In-process research and development assets acquired either through in-licensing arrangements, business combinations or separate purchases are capitalized as intangible assets as described below. Once available for use, such intangible assets are amortized on a straight-line basis over the period of the expected benefit and are reviewed for impairment at each reporting date.

Licensing, milestone and other upfront receipts and payments

Royalty income is recognized on an accrual basis in accordance with the substance of the respective licensing agreements. If the collectability of a royalty amount is not reasonably assured, those royalties are recognized as revenue when the cash is received. Certain RHI Group companies receive from third parties upfront, milestone and other similar payments relating to the sale or licensing of products or technology. Revenue associated with performance milestones is recognized based on achievement of the deliverables as defined in the respective agreements. Upfront payments and license fees for which there are subsequent deliverables are initially reported as deferred income and are recognized in income as earned over the period of the development collaboration or the manufacturing obligation.

Payments made by RHI Group companies to third parties and associates for such items are capitalized as intangible assets.

Accounting and reporting of transactions between Roche and Genentech

Within RHI's consolidated financial statements, transactions and balances between consolidated subsidiaries, such as between Genentech and other RHI Group subsidiaries, are eliminated on consolidation.

Genentech is considered a separately reportable operating segment for the purposes of RHI's operating segment disclosures in Note 2. Additional information relating to Genentech's results is given in Note 3.

Profits on product sales between the Roche Pharmaceuticals and Genentech operating segments are recorded as part of the segment results of the operating segment making the sale. Unrealized internal profits on inventories that have been sold by one operating segment to another but which have not yet been sold on to external customers as at the balance sheet date are eliminated as a consolidation entry at a Pharmaceuticals Division level.

Additionally the results of each operating segment may include income received from another operating segment in respect of:

- Royalties.
- Licensing, milestone and other upfront payments.
- Transfers in respect of research collaborations.

These are recognized as income in the segment results of the operating segment receiving the income consistently with the accounting policies applied to third-party transactions and set out in these financial statements. Corresponding expenses are recorded in the other operating segment so that these eliminate at a Pharmaceuticals Division level.

Employee benefits

Wages, salaries, social security contributions, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the RHI Group. Where the RHI Group provides long-term employee benefits, the cost is accrued to match the rendering of the services by the employees concerned. Liabilities for long-term employee benefits are discounted to take into account the time value of money, where material.

Pensions and other post-employment benefits

Most employees are covered by defined benefit and defined contribution post-employment plans sponsored by RHI Group companies. RHI's contributions to defined contribution plans are charged to the appropriate income statement heading within the operating results in the year to which they relate. The accounting and reporting of defined benefit plans are based on recent actuarial valuations. The defined benefit obligations and service costs are calculated using the projected unit credit method. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions primarily regarding discount rates used in determining the present value of benefits, projected rates of remuneration growth and long-term expected rates of return for plan assets. Discount rates are based on the market yields of high-quality corporate bonds. Past service costs are allocated over the average period until the benefits become vested. Current and past service costs are charged to the appropriate income statement heading within the operating results. Pension plan administration and funding is overseen at a corporate level and any settlement gains and losses resulting from changes in funding arrangements are reported as general and administration expenses within the 'Corporate' segment. The expected returns on plan assets and interest costs are charged to financial income and financing costs, respectively. Actuarial gains and losses, which consist of differences between assumptions and actual experiences and the effects of changes in actuarial assumptions, are recorded directly in equity. Pension assets and liabilities in different defined benefit plans are not offset unless the RHI Group has a legally enforceable right to use the surplus in one plan to settle obligations in the other plan. The recognition of pension assets is limited to the total of the

present value of any future refunds from the plans or reductions in future contributions to the plans and any cumulative unrecognized past service costs. Adjustments arising from the limit on the recognition of assets for defined benefit plans are recorded directly in equity.

Equity compensation plans

Certain employees of the RHI Group participate in equity compensation plans, including separate plans at Genentech. The fair value of all equity compensation awards granted to employees is estimated at the grant date and recorded as an expense over the vesting period. The expense is charged to the appropriate income statement heading within the operating results. For equity-settled plans, an increase in equity is recorded for this expense and any subsequent cash flows from exercises of vested awards are recorded as changes in equity. For cash-settled plans, a liability is recorded, which is measured at fair value at each balance sheet date with any movements in fair value being recorded to the appropriate income statement heading within the operating results. Any subsequent cash flows from exercise of vested awards are recorded as a reduction of the liability.

Property, plant and equipment

Property, plant and equipment are initially recorded at cost of purchase or construction, and include all costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These include items such as costs of site preparation, installation and assembly costs and professional fees. The net costs of testing whether the asset is functioning properly, including validation costs, are also included in the initially recorded cost of construction. Interest and other borrowing costs incurred with respect to qualifying assets are capitalized and included in the carrying value of the assets.

Property, plant and equipment are depreciated on a straight-line basis, except for land, which is not depreciated. Estimated useful lives of major classes of depreciable assets are as follows:

Land improvements	40 years
Buildings	10-50 years
Machinery and equipment	5-15 years
Diagnostic instruments	3-5 years
Office equipment	3 years
Motor vehicles	5 years

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate components. The estimated useful life of the assets is regularly reviewed and, if necessary, the future depreciation charge is accelerated. Repairs and maintenance costs are expensed as incurred.

Leases

Where the RHI Group is the lessee, leases of property, plant and equipment where the RHI Group has substantially all of the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the start of the lease at fair value, or the present value of the minimum lease payments, if lower. The rental obligation, net of finance charges, is reported within debt. Assets acquired under finance leases are depreciated in accordance with RHI's policy on property, plant and equipment. If there is no reasonable certainty that the RHI Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. The interest element of the lease payment is charged against income over the lease term based on the effective interest rate method. Leases where substantially all of the risks and rewards of ownership are not transferred to the RHI Group are classified as operating leases. Payments made under operating leases are charged against income on a straight-line basis over the period of the lease.

Where the RHI Group is the lessor, which primarily occurs in the Diagnostics Division, assets subject to finance leases are initially reported as receivables at an amount equal to the net investment in the lease. Assets subject to operating leases are reported within property, plant and equipment. Lease income from finance leases is subsequently recognized as earned income over the term of the lease based on the effective interest rate method. Lease income from operating leases is recognized over the lease term on a straight-line basis.

Business combinations and goodwill

Business combinations are accounted for using the purchase method of accounting. The cost of acquisition is the consideration given in exchange for control over the identifiable assets, liabilities and contingent liabilities of the acquired company. This consideration includes the cash paid plus the fair value at the date of exchange of assets given,

liabilities incurred or assumed and equity instruments issued by the RHI Group. Contingent consideration arrangements are included in cost of acquisition at fair value. Directly attributable transaction costs are expensed in the current period and reported within general and administration expenses. The acquired net assets, being the identifiable assets, liabilities and contingent liabilities, are initially recognized at fair value. Where the RHI Group does not acquire 100% ownership of the acquired company non-controlling interest are recorded as the proportion of the fair value of the acquired net assets attributable to the non-controlling interest. Goodwill is recorded as the surplus of the cost of acquisition over the RHI Group's interest in the fair value of the acquired net assets. Any goodwill and fair value adjustments are recorded as assets and liabilities of the acquired company in the functional currency of that company. Goodwill is not amortized, but is assessed for possible impairment at each balance sheet date and is additionally tested annually for impairment. Goodwill may also arise upon investments in associates, being the surplus of the cost of investment over the RHI Group's share of the fair value of the net identifiable assets. Such goodwill is recorded within investments in associates. Changes in ownership interests in subsidiaries are accounted for as equity transactions if they occur after control has already been obtained and if they do not result in a loss of control.

Intangible assets

Purchased patents, licenses, trademarks and other intangible assets are initially recorded at cost. Where these assets have been acquired through a business combination, this will be the fair value allocated in the acquisition accounting. Intangible assets are amortized over their useful lives on a straight-line basis beginning from the point when they are available for use. Estimated useful life is the lower of the legal duration and the economic useful life. The estimated useful life of intangible assets is regularly reviewed.

Impairment of property, plant and equipment and intangible assets

An impairment assessment is carried out when there is evidence that an asset may be impaired. In addition intangible assets that are not yet available for use are tested for impairment annually. When the recoverable amount of an asset, being the higher of its fair value less costs to sell and its value in use, is less than its carrying value, then the carrying value is reduced to its recoverable amount. This reduction is reported in the income statement as an impairment loss. Value in use is calculated using estimated cash flows, generally over a five-year period, with extrapolating projections for subsequent years. These are discounted using an appropriate long-term pre-tax interest rate. When an impairment loss arises, the useful life of the asset in question is reviewed and, if necessary, the future depreciation/amortization charge is accelerated. The impairment of financial assets is discussed below in the 'Financial assets' policy.

Impairment of goodwill

Goodwill is assessed for possible impairment at each balance sheet date and is additionally tested annually for impairment. Goodwill is allocated to cash-generating units as described in Note 12. When the recoverable amount of the cash-generating unit, being the higher of its fair value less costs to sell or its value in use, is less than its carrying value, then the carrying value of the goodwill is reduced to its recoverable amount. This reduction is reported in the income statement as an impairment loss. The methodology used in the impairment testing is further described in Note 12.

Inventories

Inventories are stated at the lower of cost and net realizable value. The cost of finished goods and work in process includes raw materials, direct labor and other directly attributable costs and overheads based upon the normal capacity of production facilities. Cost is determined using the weighted average method. Net realizable value is the estimated selling price less cost to completion and selling expenses.

Accounts receivable

Accounts receivable are carried at the original invoice amount less allowances made for doubtful accounts, trade discounts, cash discounts, volume rebates and similar allowances. An allowance for doubtful accounts is recorded for the difference between the carrying value and the recoverable amount where there is objective evidence that the RHI Group will not be able to collect all amounts due. Trade discounts, cash discounts, volume rebates and similar allowances are recorded on an accrual basis consistent with the recognition of the related sales, using estimates based on existing contractual obligations, historical trends and RHI's experience. Long-term accounts receivable are discounted to take into account the time value of money, where material.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and time, call and current balances with banks and similar institutions. Such balances are only reported as cash if they are readily convertible to known amounts of cash, are subject to

insignificant risk of changes in value and have a maturity of three months or less from the date of acquisition. This definition is also used for the cash flow statement.

Provisions

Provisions are recognized where a legal or constructive obligation has been incurred which will probably lead to an outflow of resources that can be reasonably estimated. In particular, restructuring provisions are recognized when the RHI Group has a detailed formal plan that has either commenced implementation or been announced. Provisions are recorded for the estimated ultimate liability that is expected to arise, taking into account the time value of money, where material. A contingent liability is disclosed where the existence of the obligation will only be confirmed by future events or where the amount of the obligation cannot be measured with reasonable reliability. Contingent assets are not recognized, but are disclosed where an inflow of economic benefits is probable.

Fair values

Fair value is the amount for which a financial asset, liability or instrument could be exchanged between knowledgeable and willing parties in an arm's length transaction. It is determined by reference to quoted market prices or by the use of established valuation techniques such as option pricing models and the discounted cash flows method if quoted prices in an active market are not available. Valuation techniques are typically used for derivative financial instruments. The fair values of financial assets and liabilities at the balance sheet date are not materially different from their reported carrying values unless specifically mentioned in the Notes to the Consolidated Financial Statements.

Financial assets

Financial assets, principally investments, including marketable securities, are classified as either 'Fair-value-through-profit-or-loss', 'Available-for-sale', 'Held-to-maturity' or 'Loans and receivables'. Fair-value-through-profit-or-loss financial assets are either classified as held-for-trading or designated upon initial recognition. Held-for-trading financial assets are acquired principally to generate profit from short-term fluctuations in price. Financial assets are designated as fair-value-through-profit-or-loss if doing so results in more relevant information by eliminating a measurement or recognition inconsistency. Held-to-maturity financial assets are securities with a fixed maturity that the RHI Group has the intent and ability to hold until maturity. Loans and receivables are financial assets created by the RHI Group or acquired from the issuer in a primary market. They are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. All other financial assets are considered to be available-for-sale.

All financial assets are initially recorded at fair value, including transaction costs, except for assets at fair-value-through-profit-or-loss, which exclude transaction costs. All purchases and sales are recognized on the settlement date. Fair-value-through-profit-or-loss financial assets are subsequently carried at fair value, with all changes in fair value recorded as financial income in the period in which they arise. Held-to-maturity financial assets are subsequently carried at amortized cost using the effective interest rate method. Available-for-sale financial assets are subsequently carried at fair value, with all unrealized changes in fair value recorded in equity except for interest calculated using the effective interest rate method and foreign exchange components. When the available-for-sale financial assets are sold, impaired or otherwise disposed of, the cumulative gains and losses previously recognized in equity are included in financial income for the current period. Loans and receivables are subsequently carried at amortized cost using the effective interest rate method.

Financial assets are individually assessed for possible impairment at each balance sheet date. An impairment charge is recorded where there is objective evidence of impairment, such as where the issuer is in bankruptcy, default or other significant financial difficulty. In addition any available-for-sale equity securities that have a market value of more than 25% below their original cost, net of any previous impairment, will be considered as impaired. Any available-for-sale equity securities that have a market value below their original cost, net of any previous impairment, for a sustained six-month period will also be considered as impaired. Any decreases in the market price of less than 25% of original cost, net of any previous impairment, which are also for less than a sustained six-month period are not by themselves considered as objective evidence of impairment. Such movements in fair value are recorded in equity until there is objective evidence of impairment or until the asset is sold or otherwise disposed of. For financial assets carried at amortized cost, any impairment charge is the difference between the carrying value and the recoverable amount, calculated using estimated future cash flows discounted using the original effective interest rate. For available-for-sale financial assets, any impairment charge is the amount currently carried in equity for the difference between the original cost, net of any previous impairment, and the fair value. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For debt securities measured at amortized cost or available-for-sale, the reversal is recognized in income. For equity securities held available-for-sale, the reversal is recognized directly in equity.

A financial asset is derecognized when the contractual cash flows from the asset expire or when the Group transfers the rights to receive the contractual cash flows from the financial assets in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognized as a separate asset or liability.

Derivatives

Derivative financial instruments are initially recorded and subsequently carried at fair value. Apart from those derivatives designated as qualifying cash flow hedging instruments as discussed in the 'Hedging' policy below, all changes in fair value are recorded as financial income in the period in which they arise. Embedded derivatives are recognized separately if not closely related to the host contract and where the host contract is carried at amortized cost.

Hedging

For the purposes of hedge accounting, hedging relationships may be of three types. Fair value hedges are hedges of particular risks that may change the fair value of a recognized asset or liability. Cash flow hedges are hedges of particular risks that may change the amount or timing of future cash flows. Hedges of net investment in a foreign entity are hedges of particular risks that may change the carrying value of the net assets of a foreign entity.

To qualify for hedge accounting the hedging relationship must meet several strict conditions on documentation, probability of occurrence (for cash flow hedges), hedge effectiveness and reliability of measurement. If these conditions are not met, then the relationship does not qualify for hedge accounting. In this case the hedging instrument and the hedged item are reported independently as if there were no hedging relationship. In particular any derivatives are reported at fair value, with changes in fair value included in financial income.

For qualifying fair value hedges, the hedging instrument is recorded at fair value and the hedged item is recorded at its previous carrying value, adjusted for any changes in fair value that are attributable to the hedged risk. Any changes in the fair values are reported in financial income.

For qualifying cash flow hedges, the hedging instrument is recorded at fair value. The portion of any change in fair value that is an effective hedge is included in equity, and any remaining ineffective portion is reported in financial income. If the hedging relationship is the hedge of the foreign currency risk of a firm commitment or highly probable forecasted transaction that results in the recognition of a non-financial asset or liability, the cumulative changes in the fair value of the hedging instrument that have been recorded in equity are included in the initial carrying value of the asset or liability at the date of recognition. For all other qualifying cash flow hedges, the cumulative changes in the fair value of the hedging instrument that have been recorded in equity are included in financial income when the forecasted transaction affects net income.

For qualifying hedges of net investment in a foreign entity, the hedging instrument is recorded at fair value. The portion of any change in fair value that is an effective hedge is included in equity. Any remaining ineffective portion is recorded in financial income where the hedging instrument is a derivative and in equity in other cases. If the entity is disposed of, then the cumulative changes of fair value of the hedging instrument that have been recorded in equity are reclassified to income.

Debt instruments

Debt instruments are initially recorded at cost, which is the proceeds received, net of transaction costs. Subsequently they are reported at amortized cost. Any discount between the net proceeds received and the principal value due on redemption is amortized over the duration of the debt instrument and is recognized as part of financing costs using the effective interest rate method. Certain debt instruments may be designated as 'fair-value-through-profit-or-loss' where doing so results in more relevant information as it eliminates or significantly reduces measurement or recognition inconsistencies. Such debt instruments are reported at fair value, based on quoted prices in an active market, with movements in fair value reported within financial income. Those debt instruments that are designated as fair-value-through-profit-or-loss are disclosed in Note 26. The Group derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired.

Taxation

Income taxes include all taxes based upon the taxable profits of the RHI Group, including withholding taxes payable on the distribution of retained earnings within the RHI Group. Other taxes not based on income, such as property and capital taxes, are included within general and administration expenses.

Liabilities for income taxes, mainly withholding taxes, which could arise on the remittance of retained earnings, principally relating to subsidiaries, are only recognized where it is probable that such earnings will be remitted in the foreseeable future.

Deferred income tax assets and liabilities are recognized on temporary differences between the tax bases of assets and liabilities and their carrying values in the financial statements. Deferred income tax assets relating to the carry-forward of unused tax losses are recognized to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilized.

Current and deferred income tax assets and liabilities are offset when the income taxes are levied by the same taxation authority and when there is a legally enforceable right to offset them. Deferred income taxes are determined based on the currently enacted tax rates applicable in each tax jurisdiction where the RHI Group operates.

Discontinued businesses and non-current assets held for sale

A discontinued business is a component of the RHI Group's business that represents a separate major line of business or is a subsidiary acquired exclusively with a view to resale. Reclassification as a discontinued business occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier.

A disposal group is a group of assets that are to be disposed of as a group in a single transaction, together with the liabilities directly associated with those assets that will be transferred in the transaction. The assets and liabilities in a disposal group are reclassified as held for sale if their value will be recovered principally through a sale rather than through continuing use. The disposal group must be available for sale in its current condition and the sale must be highly probable.

Immediately before classification as held for sale, the measurement of all assets and liabilities in a disposal group is updated in accordance with applicable accounting policies. Then, on initial classification as held for sale, disposal groups are recognized at the lower of carrying value and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the income statement.

Management judgments made in applying accounting policies

The application of RHI's accounting policies may require management to make judgments, apart from those involving estimates, that can have a significant effect on the amounts recognized in the consolidated financial statements. Management judgment is particularly required when assessing the substance of transactions that have a complicated structure or legal form. These include, but are not limited to, the following areas:

Revenue recognition: The nature of RHI's business is such that many sales transactions do not have a simple structure. Sales agreements may consist of multiple components occurring at different times. RHI is also party to various out-licensing agreements, which can involve upfront and milestone payments that may occur over several years. These agreements may also involve certain future obligations. Revenue is only recognized when, in management's judgment, the significant risks and rewards of ownership have been transferred and when the RHI Group does not retain continuing managerial involvement or effective control over the goods sold or when the obligation has been fulfilled. For some transactions this can result in cash receipts being initially recognized as deferred income and then released to income over subsequent periods on the basis of the performance of the conditions specified in the agreement.

Consolidation of subsidiaries and associates: The RHI Group periodically undertakes transactions that may involve obtaining the right to control or significantly influence the operations of other companies. These transactions include the acquisition of all or part of the equity of other companies, the purchase of certain assets and assumption of certain liabilities and contingent liabilities of other companies, and entering into alliance agreements with other companies. Also included are transactions involving Special Purpose Entities and similar vehicles. In all such cases management makes an assessment as to whether the RHI Group has the right to control or significantly influence the other company's operations, and based on this assessment the other company is consolidated as a subsidiary or associated company. In making this assessment management considers the underlying economic substance of the transaction and not only the contractual terms.

Business combinations: Where the RHI Group acquires control of another business, the cost of the acquisition has to be allocated to the assets, liabilities and contingent liabilities of the acquired business, with any residual recorded as

goodwill. This process involves management making an assessment of the fair value of these items. Management judgment is particularly involved in the recognition and measurement of the following items:

- Intellectual property. This may include patents, licenses, trademarks and similar rights for currently marketed products and also the rights and scientific knowledge associated with projects that are currently in research or development phases.
- Contingencies such as legal and environmental matters.
- Contingent consideration arrangements.
- The recoverability of any accumulated tax losses previously incurred by the acquired company.

In all cases management makes an assessment based on the underlying economic substance of items concerned, and not only on the contractual terms, in order to fairly present these items.

Leases: The RHI Group is party to leasing arrangements, both as a lessee and as a lessor. The treatment of leasing transactions in the financial statements is mainly determined by whether the lease is considered to be an operating lease or a finance lease. In making this assessment, management looks at the substance of the lease, as well as the legal form, and makes a judgment about whether substantially all of the risks and rewards of ownership are transferred. Arrangements which do not take the legal form of a lease but that nevertheless convey the right to use an asset are also covered by such assessments.

Key assumptions and sources of estimation uncertainty

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income, expenses and related disclosures. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Changes in accounting estimates may be necessary if there are changes in the circumstances on which the estimate was based, or as a result of new information or more experience. Such changes are recognized in the period in which the estimate is revised.

The key assumptions about the future and key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying value of assets and liabilities within the next twelve months are described below.

Sales allowances: The RHI Group has provisions and accruals for expected sales returns, charge-backs and other rebates, including Medicaid in the United States, which at December 31, 2008 was \$694 million. Such estimates are based on analyses of existing contractual or legislatively-mandated obligations, historical trends and RHI's experience. Management believes that the total provisions and accruals for these items are adequate, based upon currently available information. As these deductions are based on management estimates, they may be subject to change as better information becomes available. Such changes that arise could impact the provisions and accruals recognized in the balance sheet in future periods and consequently the level of sales recognized in the income statement in future periods.

Property, plant and equipment and intangible assets, including goodwill: The RHI Group has property, plant and equipment with a carrying value of \$7,615 million as disclosed in Note 11. Goodwill has a carrying value of \$4,096 million (see Note 12) and intangible assets have a carrying value of \$3,344 million (see Note 13). All of these assets are reviewed annually for impairment as described above. To assess whether any impairment exists, estimates are made of the future cash flows expected to result from the use of the asset and its eventual disposal. Actual outcomes could vary significantly from such estimates of discounted future cash flows. Factors such as changes in the planned use of buildings, machinery or equipment, or closure of facilities, the presence or absence of competition, technical obsolescence or lower than anticipated sales of products with capitalized rights could result in shortened useful lives or impairment. Changes in the discount rates used could also lead to impairments.

Pensions and other post-employment benefits: Many of RHI's employees participate in post-employment defined benefit plans. The calculations of the recognized assets and liabilities from such plans are based upon statistical and actuarial calculations. In particular the present value of the defined benefit obligation is impacted by assumptions on discount rates used to arrive at the present value of future pension liabilities, and assumptions on future increases in salaries and benefits. Furthermore, RHI's independent actuaries use statistically based assumptions covering areas such as future withdrawals of participants from the plan and estimates of life expectancy. At December 31, 2008 the present

value of RHI's defined benefit obligation is \$3,276 million for funded plans and \$315 million for unfunded plans (see Note 9). The actuarial assumptions used may differ materially from actual results due to changes in market and economic conditions, higher or lower withdrawal rates, longer or shorter life spans of participants, and other changes in the factors being assessed. These differences could impact the assets or liabilities recognized in the balance sheet in future periods.

Legal provisions: The RHI Group is party to various legal proceedings including claims arising from trade, and the most significant matters are described in Note 24. Legal provisions at December 31, 2008 total \$126 million. Additional claims could be made which might not be covered by existing provisions or by insurance. There can be no assurance that there will not be an increase in the scope of these matters or that any future lawsuits, claims, proceedings or investigations will not be material. Such changes that arise could impact the provisions recognized in the balance sheet in future periods.

Environmental provisions: The RHI Group has provisions for environmental remediation costs, which at December 31, 2008 total \$93 million, as disclosed in Note 24. The material components of the environmental provisions consist of costs to fully clean and refurbish contaminated sites and to treat and contain contamination at certain other sites. Future remediation expenses are affected by a number of uncertainties that include, but are not limited to, the detection of previously unknown contaminated sites, the method and extent of remediation, the percentage of waste material attributable to the RHI Group at the remediation sites relative to that attributable to other parties, and the financial capabilities of the other potentially responsible parties. Management believes that the total provisions for environmental matters are adequate based upon currently available information. However, given the inherent difficulties in estimating liabilities in this area, it cannot be guaranteed that additional costs will not be incurred beyond the amounts accrued. The effect of the resolution of environmental matters on the results of operations cannot be predicted due to uncertainty concerning both the amount and the timing of future expenditures. Such changes that arise could impact the provisions recognized in the balance sheet in future periods.

Income taxes: At December 31, 2008, the net liability for current income taxes is \$481 million and the net asset for deferred income taxes is \$823 million, as disclosed in Note 5. Significant estimates are required to determine the current and deferred assets and liabilities for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. Management believes that the estimates are reasonable and that the recognized liabilities for income tax-related uncertainties are adequate. Various internal and external factors may have favorable or unfavorable effects on the income tax assets and liabilities. These factors include, but are not limited to, changes in tax laws, regulations and/or rates, changing interpretations of existing tax laws or regulations, future levels of research and development spending and changes in overall levels of pre-tax earnings. Such changes that arise could impact the assets and liabilities recognized in the balance sheet in future periods.

Changes in accounting policies

In 2007 the RHI Group early adopted IFRS 8 'Operating Segments' and IAS 23 (revised) 'Borrowing Costs' which are required to be implemented from January 1, 2009 at the latest. In 2008 the RHI Group has early adopted the revised versions of IFRS 3 'Business Combinations', IAS 27 'Consolidated and Separate Financial Statements' that were published in early 2008 and which are required to be implemented from January 1, 2010 at the latest. The Group has implemented the amendments to IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' published in October 2008 relating to the reclassification of Financial Assets. The RHI Group has also adopted IFRIC interpretation 14 which relates to IAS 19 'Employee benefits'.

The RHI Group is currently assessing the potential impacts of the other new and revised standards and interpretations that will be effective from January 1, 2009 and beyond, and which the RHI Group has not early adopted. These include further revisions to IAS 1 'Presentation of Financial Statements' and revisions to IFRS 2 'Share based Payment'. The RHI Group does not anticipate that these will have a material impact on the RHI Group's overall results and financial position.

IFRS 3 (revised): 'Business combinations'. Amongst other matters, the revised standard requires that directly attributable transaction costs are expensed in the current period, rather than being included in the cost of acquisition as previously. The revised standard also requires that contingent consideration arrangements should be included in acquisition accounting at fair value and expands the disclosure requirements for business combinations. The RHI Group has applied the revised standard prospectively for all business combinations since January 1, 2008 and directly attributable transaction costs totaling \$39 million have been expensed in 2008 that would have been included in the cost of acquisition under the previous accounting policy. Business combinations in 2007 and prior periods have not

been restated. Had the new accounting policy been applied in 2007, the RHI Group would have expensed an additional \$9 million of directly attributable transaction costs in that year and goodwill would have been reduced by this amount.

IAS 27 (revised): 'Consolidated and separate financial statements'. Amongst other matters, the revised standard requires that changes in ownership interests in subsidiaries are accounted for as equity transactions if they occur after control has already been obtained and if they do not result in a loss of control. Additionally the revised standard renames "minority interests" as "non-controlling interests". The RHI Group has applied the revised standard retrospectively. There were no transactions in 2007 that required restatement.

IAS 39 'Financial Instruments: Recognition and Measurement and IFRS 7 'Financial Instruments: Disclosures'. These amendments relate to the reclassification of financial assets and have been applied prospectively by the Group from July 1, 2008. The application of these amendments had no significant impact on the RHI Group's results.

IFRIC interpretation 14 to IAS 19: 'Employee benefits'. The interpretation adds to the existing requirements of IAS 19 regarding the interaction between the limits on recognition of assets from defined benefit post-employment plans and any minimum funding requirement of such plans. This has no impact on the RHI Group's pension plans in the US and therefore no restatement of the 2007 reported figures was necessary.

2. Operating segment information

Divisional information in millions of USD

	Pharmaceuticals Division		Diagnostics Division		Corporate		RHI Group	
	2008	2007	2008	2007	2008	2007	2008	2007
Revenues from external customers and related parties								
Sales	14,088	13,419	2,709	2,286	-	-	16,797	15,705
Royalties and other operating income	3,053	2,619	65	90	-	-	3,118	2,709
Total	17,141	16,038	2,774	2,376	-	-	19,915	18,414
Segment results								
Operating profit before exceptional items	5,950	5,221	(86)	141	(4)	6	5,860	5,368
Major legal cases	250	-	-	-	-	-	250	-
Changes in RHI Group organization	(225)	-	-	-	-	-	(225)	-
Operating profit	5,975	5,221	(86)	141	(4)	6	5,885	5,368
Capital expenditure								
Business combinations	152	950	2,930	434	-	-	3,082	1,384
Additions to property, plant and equipment	912	1,231	213	166	-	-	1,125	1,397
Additions to intangible assets	475	589	-	8	-	-	475	597
Total capital expenditure	1,539	2,770	3,143	608	-	-	4,682	3,378
Research and development								
Research and development costs	3,571	3,212	50	(4)	-	-	3,621	3,208
Other segment information								
Depreciation of property, plant and equipment	454	399	110	80	-	-	564	479
Amortization of intangible assets	190	234	115	44	-	-	305	278
Impairment of property, plant and equipment	9	-	8	1	-	-	17	1
Impairment of goodwill	-	-	-	-	-	-	-	-
Impairment of intangible assets	39	39	-	-	-	-	39	39
Equity compensation plan expenses	377	431	14	11	2	1	393	443

Pharmaceuticals sub-divisional information *in millions of USD*

	Roche Pharmaceuticals		Genentech		Pharmaceuticals Division	
	2008	2007	2008	2007	2008	2007
Revenues from external customers and related parties						
Sales	3,557	3,976	10,531	9,443	14,088	13,419
Royalties and other operating income	329	463	2,724	2,156	3,053	2,619
Total	3,886	4,439	13,255	11,599	17,141	16,038
Revenues from other operating segments						
	-	-	-	-	-	-
Segment results						
Operating profit before exceptional items	573	807	5,377	4,414	5,950	5,221
Elimination of profit within division	-	-	-	-	-	-
Sub-total	573	807	5,377	4,414	5,950	5,221
Major legal cases	-	-	250	-	250	-
Changes in RHI Group organization	(138)	-	(87)	-	(225)	-
Operating profit	435	807	5,540	4,414	5,975	5,221
Capital expenditure						
Business combinations	152	61	-	889	152	950
Additions to property, plant and equipment	125	125	787	1,106	912	1,231
Additions to intangible assets	253	354	222	235	475	589
Total capital expenditure	530	540	1,009	2,230	1,539	2,770
Research and development						
Research and development costs	1,056	981	2,515	2,231	3,571	3,212
Elimination of costs within division	-	-	-	-	-	-
Total	1,056	981	2,515	2,231	3,571	3,212
Other segment information						
Depreciation of property, plant and equipment	144	119	310	280	454	399
Amortization of intangible assets	14	84	176	150	190	234
Impairment of property, plant and equipment	9	-	-	-	9	-
Impairment of goodwill	-	-	-	-	-	-
Impairment of intangible assets	39	4	-	35	39	39
Equity compensation plan expenses	36	44	341	387	377	431

Net operating assets *in millions of USD*

	Assets		Liabilities		Net assets	
	2008	2007	2008	2007	2008	2007
Roche Pharmaceuticals	3,492	3,740	(1,387)	(1,177)	2,105	2,563
Genentech	11,720	11,527	(2,582)	(3,594)	9,138	7,933
Pharmaceuticals Division	15,212	15,267	(3,969)	(4,771)	11,243	10,496
Diagnostics Division	6,147	3,134	(853)	(753)	5,294	2,381
Corporate	409	118	(347)	(25)	62	93
Total operating	21,768	18,519	(5,169)	(5,549)	16,599	12,970
Non-operating	11,226	8,240	(13,634)	(9,356)	(2,408)	(1,116)
RHI Group	32,994	26,759	(18,803)	(14,905)	14,191	11,854

Major customers

Substantially all of the RHI Group's third party sales are to customers in the United States. The U.S. national wholesale distributors, AmerisourceBergen Corp., Cardinal Health, Inc. and McKesson Corp. each contributed more than 10% of the RHI Group's revenues. The total amounts of revenues are approximately \$6 billion (2007: \$5 billion), \$3 billion (2007: \$2 billion) and \$4 billion (2007: \$3 billion), respectively. These revenues arose primarily in the Genentech operating segment with the residual in the Roche Pharmaceuticals and Diagnostics segments.

3. Genentech

Effective September 7, 1990 the RHI Group acquired a majority interest of approximately 60% of Genentech, Inc., a biotechnology company in the United States. On June 13, 1999 RHI exercised its option to acquire the remaining shares of Genentech on June 30, 1999, at which point Genentech became a 100% owned subsidiary RHI. On July 23, 1999, October 26, 1999 and March 29, 2000 RHI completed public offerings of Genentech's common stock, which reduced RHI's majority interest to 60%. During 2004 RHI's ownership of Genentech decreased by 2.45% due to the conversion and redemption of the 'LYONs IV' U.S. dollar exchangeable notes. At December 31, 2008 RHI's interest in Genentech was 55.8% (2007: 55.8%).

The common stock of Genentech is publicly traded and is listed on the New York Stock Exchange, under the symbol 'DNA'. Genentech prepares financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP). These are filed on a quarterly basis with the U.S. Securities and Exchange Commission (SEC).

Roche's proposal to fully purchase Genentech

On July 21, 2008 the Group announced a proposal to purchase all of the outstanding shares of Genentech common stock not owned by Roche at a price of \$89.00 in cash per share, equivalent to a total cash payment of approximately \$43.7 billion (the 'Roche Proposal'). On July 24, 2008 Genentech announced that a special committee of its Board of Directors composed of its independent directors (the 'Special Committee') had been formed to review, evaluate, and, in the Special Committee's discretion, negotiate and recommend or not recommend the acceptance of the Roche Proposal. On August 13, 2008 Genentech announced that the Special Committee did not support the proposal.

The impacts of the Roche Proposal on the 2008 results are described in Note 7.

Roche's relationship with Genentech

Genentech has entered into certain agreements with the Roche Group, which are discussed below:

Affiliation Arrangements: As a result of the June 1999 redemption of Genentech's Special Common Stock and subsequent public offerings, Genentech amended their certificate of incorporation and bylaws and entered into or amended certain affiliation arrangements with the Roche Group. Amongst other matters these cover the following areas:

- Roche's rights as a shareholder.
- Roche's rights to nominate members of Genentech's Board of Directors.
- Certain limitations on Roche's ability to buy or sell Genentech's common stock.
- The process under which Roche may effect a merger of Genentech with Roche.
- The approval of the directors designated by Roche should Genentech seek to make significant business acquisitions or divestments.

- The approval of the directors designated by Roche should Genentech seek to issue, repurchase or redeem its capital stock.

Genentech issues additional shares of common stock in connection with its equity compensation plans, and may issue additional shares for other purposes, which affects Roche's percentage ownership interest. The affiliation agreement between Roche and Genentech provides, amongst other matters, that Genentech establishes a stock repurchase program to maintain Roche's percentage ownership interest in Genentech.

Licensing Agreements: In July 1999 Roche and Genentech agreed an amended and restated licensing and marketing agreement granting Roche an option to license, use and sell Genentech's products in non-U.S. markets. This licensing and marketing agreement was subsequently amended to delete or add certain Genentech products under Roche's commercialization and marketing rights for Canada. In addition, Roche and Genentech have a July 1998 licensing and marketing agreement relating to anti-HER2 antibodies (Herceptin and pertuzumab), providing Roche with exclusive marketing rights outside of the U.S.

Depending on the specific circumstances and the terms of the agreement, this may result in payments on an arm's-length basis from Roche to Genentech, for any or all of the following matters:

- Fees to extend Roche's option to license a product.
- Partial reimbursement of Genentech's previously incurred development costs where Roche exercises an option to license a product.
- Milestones and similar payments, dependent upon the achievement of agreed objectives or performance targets.
- Royalties on Roche's aggregate sales of that product.

Manufacturing Agreements: Genentech has agreed, in general, to manufacture for and supply to Roche its clinical requirements at cost and its commercial requirements on a cost plus basis. Roche has the right to manufacture Genentech's products under certain circumstances. In July 2006, Roche and Genentech signed two new product supply agreements, each of which was amended in November 2007. The Umbrella Manufacturing Supply Agreement (or "Umbrella Agreement") supersedes any existing product supply agreements. Under this agreement, Roche has agreed to purchase specified amounts of Herceptin and Avastin through 2012 and, on a perpetual basis, either party may order other collaboration products from the other, including Herceptin and Avastin after 2012. The Short-Term Supply Agreement (or "Short-Term Agreement") supplements the terms of the Umbrella Agreement. Under this agreement, Roche has agreed to purchase specified amounts of Herceptin, Avastin and MabThera/Rituxan through 2008.

Research Collaboration Agreement: In April 2004, Roche and Genentech entered into a research collaboration agreement that outlines the process by which the parties may agree to conduct and share in the costs of joint research on certain molecules. The agreement further outlines how development and commercialization efforts will be coordinated with respect to select molecules, including the financial provisions for a number of different development and commercialization scenarios undertaken by either or both parties.

Tax Sharing Agreement: Roche and Genentech have a tax sharing agreement that relates to the US state and local tax returns in which they are consolidated or combined. Genentech calculates its tax liability or refund with the Group for these state and local jurisdictions as if Genentech were a stand-alone entity.

Genentech share repurchases

On April 15, 2008 Genentech's Board of Directors approved an extension of the existing stock repurchase program authorizing Genentech to repurchase up to 150 million shares of Genentech's common stock for a total of \$10 billion through June 30, 2009. Since the program's inception, Genentech has repurchased approximately 89 million shares for a total of approximately \$6.5 billion.

During 2008 the net cash outflow from repurchases of Genentech common stock was \$780 million (2007: \$1,344 million, which includes \$300 million from the prepaid share repurchase program).

Manufacturing agreements with Lonza

Effective December 8, 2006 Genentech sold its wholly-owned subsidiary Genentech España, including the manufacturing facility in Porriño, Spain, to Lonza Group Ltd. ('Lonza') for \$150 million. As part of this agreement Genentech has entered into a short-term supply contract with Lonza for the production of Avastin using a portion of the production capacity of the Porriño facility. At the same time Genentech has entered into a supply agreement for the manufacture of certain Genentech products at Lonza's facility under construction in Singapore which is currently

expected to receive U.S. Food and Drug Administration ('FDA') licensure in 2010. Genentech is committed to fund the pre-commissioning production qualification costs at this facility and, upon FDA licensure, Genentech is committed to purchase 100% of products successfully manufactured at the facility for a period of three years after commissioning of the facility. The estimated total cost of these pre- and post-commissioning commitments is approximately \$440 million. Genentech has also received an exclusive option to purchase the Lonza Singapore facility during the period from 2007 up to one year after FDA licensure for a purchase price of \$290 million. Regardless of whether the purchase option is exercised, Genentech will be obliged to make a milestone payment of \$70 million if certain performance milestones are met at the facility being constructed. For accounting purposes, due to the nature of the supply agreement and Genentech's involvement in the construction of the buildings, Genentech is considered to be the owner of the assets during the construction period even though the funds to construct the building shell and some infrastructure costs are paid by Lonza.

Genentech has also entered into a loan agreement with Lonza to advance up to \$299 million to Lonza for the construction of the Singapore facility. As at December 31, 2008 a total of \$225 million has been advanced (2007: \$25 million). If Genentech exercises its option to purchase the facility then any outstanding advances may be offset against the purchase price. If Genentech does not exercise its purchase option then the advances may be offset against supply purchases.

As at December 31, 2008, construction in progress totaling \$268 million (2007: \$162 million) has been capitalized and a net financing obligation totaling \$43 million (2007: \$138 million) has been recorded.

Leasing arrangements

In December 2004 Genentech entered into a Master Lease Agreement with Slough SSF, LLC, which was subsequently acquired by Health Care Properties ('HCP'), for the development of property adjacent to Genentech's South San Francisco site. The development includes a total of eight buildings, which are subject to separate agreements as contemplated by the Master Lease Agreement. HCP as the developer will construct the building shell for each building and Genentech will finish the interior of each building as laboratory or office space, as applicable. The construction of the first buildings was completed in 2006, at which point the lease term for those buildings was deemed to begin. Construction of the final buildings was completed during 2008. The lease term expires twelve years from the occupation of the final building. Genentech has two five-year renewal options for each building and has an option to purchase the various buildings at different dates between 2016 and 2020. Genentech also has a right of first refusal with respect to each building or the entire development should HCP consider selling part or all of the development.

As at December 31, 2008, based on the status of the development to date, the total carrying value of property, plant and equipment from this agreement was \$226 million (2007: \$232 million) and the carrying value of the leasing obligation was \$274 million (2007: \$270 million). Estimates of the total future minimum lease payments anticipated by the entire Master Lease Agreement are shown below.

Estimated total future minimum lease payments under HCP leases *in millions of USD*

	Principal	Ground lease	Interest	Total minimum lease payments
Within one year	11	7	18	36
Between one and five years	64	30	63	157
More than five years	196	52	50	298
Total	271	89	131	491

Other matters

Details of other Genentech matters are given in the following Notes:

- Acquisition of Tanox in 2007: Note 6.
- Changes in RHI Group organization: Note 7.
- Genentech's equity compensation plans: Note 10.
- Genentech legal cases: Note 24.
- Genentech's Senior Notes and Commercial Paper Program: Note 26.

4. Financial income and financing costs

Financial income in millions of USD

	Year ended December 31,	
	2008	2007
Gains on sale of equity securities	109	56
Gains (losses) on equity security derivatives, net	-	(2)
Write-downs and impairments of equity securities	(84)	(21)
Net income from equity securities	25	33
Interest income	253	326
Gains on sale of debt securities	22	119
(Losses) on sale of debt securities	(63)	(140)
Gains (losses) on debt security derivatives, net	-	-
Net gains (losses) on financial assets at fair-value-through-profit-or-loss	(51)	16
Write-downs and impairments of debt securities	-	(30)
Net interest income and income from debt securities	161	291
Expected return on plan assets of defined benefit plans ⁹	260	243
Foreign exchange gains (losses), net	(6)	-
Gains (losses) on foreign currency derivatives, net	-	(1)
Net foreign exchange (losses)	(6)	(1)
Net other financial income (expense)	(18)	-
Total financial income	422	566

Financing costs in millions of USD

	Year ended December 31,	
	2008	2007
Interest expense	(118)	(131)
Amortization of discount on debt instruments	-	(6)
Gains (losses) on debt derivatives, net	(2)	-
Net gains (losses) on financial liabilities at fair-value-through-profit-or-loss	11	2
Time cost of provisions ²⁴	(18)	(56)
Interest cost of defined benefit plans ⁹	(214)	(196)
Total financing costs	(341)	(387)

Net financial income in millions of USD

	Year ended December 31,	
	2008	2007
Financial income	422	566
Financing costs	(341)	(387)
Net financial income	81	179
Financial result from Treasury management	35	132
Financial result from Pension management	46	47
Net financial income	81	179

Net gains (losses) on financial liabilities at fair-value-through-profit-or-loss includes the change in the fair value that is attributable to changes in the liabilities' credit risk component. This is calculated by comparing the difference between the present value of the future cash flows on the bonds, discounted by using a swap yield curve based on LIBOR, and the market prices of the bonds. Due to a widening of the credit spread during 2008 relative to the swap yield curve, the change in fair value that is attributable to changes in the liabilities' credit risk component was a gain of \$3 million (2007: gain of \$4 million). The cumulative change in fair value that is attributable to the change in credit risk since the issuance of the instruments was a gain of \$1 million (2007: loss of \$2 million). Interest expense on liabilities at fair-

value-through-profit-or-loss was \$33 million (2007: \$33 million). Interest income includes interest on financial assets held at fair-value-through-profit-and-loss amount of \$41 million (2007: \$38 million).

5. Income taxes

Income tax expenses in millions of USD

	2008	2007
Current income taxes	(2,033)	(2,165)
Adjustments recognized for current tax of prior periods	(22)	5
Deferred income taxes	(98)	63
Total income (expense)	(2,153)	(2,097)

RHI's effective tax rate can be reconciled to the RHI Group's average expected tax rate as follows:

Reconciliation of RHI's effective tax rate

	2008	2007
Average expected tax rate	35.0%	35.0%
Tax effect of		
- Utilization of previously unrecognized tax losses	-0.0%	-0.0%
- Non-taxable income/non-deductible expenses	+0.4%	-
- Genentech equity compensation plans	+1.1%	+2.4%
- Other differences	+2.2%	+1.6%
RHI's effective tax rate before exceptional items	38.7%	39.0%

	2008			2007		
	Profit before tax (mUSD)	Income taxes (mUSD)	Tax rate (%)	Profit before tax (mUSD)	Income taxes (mUSD)	Tax rate (%)
RHI's effective tax rate before exceptional items	5,530	(2,141)	38.7	5,376	(2,097)	39.0%
Major legal cases ²⁴	250	(98)	39.2	-	-	-
Changes in RHI Group organization ⁷	(225)	86	38.2	-	-	-
RHI's effective tax rate	5,555	(2,153)	38.8	5,376	(2,097)	39.0%

Income tax assets (liabilities) in millions of USD

	2008	2007
Current income taxes		
- Assets	103	7
- Liabilities	(584)	(411)
Net current income tax assets (liabilities)	(481)	(404)
Deferred income taxes		
- Assets	1,224	857
- Liabilities	(401)	(106)
Net deferred income tax assets (liabilities)	823	751

Deferred income tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. The RHI Group has unrecognized tax losses, including valuation allowances, as follows:

Unrecognized tax losses: expiry in millions of USD

	2008		2007	
	Amount	Applicable tax rate	Amount	Applicable tax rate
Within one year	-	-	-	-
Between one and five years	-	-	-	-
More than five years	39	35%	39	35%
Total unrecognized tax losses	39	35%	39	35%

Deferred income tax liabilities have not been established for the withholding tax and other taxes that would be payable on the unremitted earnings, as such amounts are currently regarded as permanently reinvested. There were no net unremitted earnings at December 31, 2008 (2007: \$809 million).

The deferred income tax assets and liabilities and the deferred income tax charges (credits) are attributable to the following items:

Deferred income taxes: movements in recognized net assets (liabilities) in millions of USD

	Property, plant and equipment, and intangible assets	Other temporary differences	Total
Year ended December 31, 2007			
Net deferred income tax asset (liability) at January 1, 2007	(501)	1,640	1,139
Tanox acquisition ⁶	(235)	35	(200)
Other business combinations ⁶	(81)	45	(36)
(Charged) credited to the income statement	63	-	63
(Charged) credited to equity from other recognized gains and losses ²⁷	-	(48)	(48)
(Charged) credited to equity from equity compensation plans and other transactions with shareholders	-	(182)	(182)
Other	-	15	15
Net deferred income tax asset (liability) at December 31, 2007	(754)	1,505	751
Year ended December 31, 2008			
Net deferred income tax asset (liability) at January 1, 2008	(754)	1,505	751
Ventana acquisition ⁶	(494)	112	(382)
Mirus acquisition ⁶	(34)	2	(32)
(Charged) credited to the income statement	(48)	(50)	(98)
(Charged) credited to equity from other recognized gains and losses ²⁷	-	404	404
(Charged) credited to equity from equity compensation plans and other transactions with shareholders	-	115	115
Other	9	56	65
Net deferred income tax asset (liability) at December 31, 2008	(1,321)	2,144	823

6. Business combinations

Acquisitions – 2008

Ventana: Ventana Medical Systems, Inc. ('Ventana') was a publicly owned U.S. company based in Tucson, Arizona that had been listed on the NASDAQ under the symbol 'VMSI'. Prior to February 8, 2008, the RHI Group owned shares in Ventana representing 0.4% of the outstanding shares of Ventana. Effective February 8, 2008 the RHI Group acquired a further 70.5% of the outstanding shares of Ventana and obtained control of Ventana. Ventana develops, manufactures and markets instrument/reagent systems that automate slide preparation and staining in clinical histology and drug discovery laboratories. Ventana's clinical systems are used in the diagnosis and treatment of cancer and infectious diseases and their drug discovery systems are used by pharmaceutical and biotechnology companies to accelerate the discovery of new drug targets and to evaluate the safety of new drug compounds. Ventana is now reported as part of the Diagnostics operating segment. The acquisition of Ventana, a leader in the fast-growing histopathology (tissue-based diagnostics) business segment, will allow the Roche Group to broaden its diagnostic offerings and complement its world leadership in both in-vitro diagnostic systems and oncology therapies.

The purchase consideration was \$2,294 million in cash. This has been allocated as follows:

Ventana acquisition: net assets acquired *in millions of USD*

	Carrying value prior to acquisition	Fair value adjustments	Carrying value upon acquisition
Property, plant and equipment	79	7	86
Goodwill	15	(15)	-
Intangible assets			
- Product intangibles: in use	15	727	742
- Product intangibles: not available for use	0	516	516
Inventories	23	31	54
Deferred income taxes	109	(491)	(382)
Cash	41	-	41
Other net assets (liabilities)	(43)	(15)	(58)
Net identifiable assets	239	760	999
Non-controlling interests			(291)
Goodwill			1,586
Purchase consideration			2,294

Goodwill represents the strategic value to the Roche Group of entering the tissue diagnostics business area. It also represents the premium paid over the traded market price to obtain control of the business. None of the goodwill recognized is expected to be deductible for income tax purposes. The non-controlling interests in Ventana were measured at their proportionate share (29.1%) of Ventana's identifiable net assets.

The fair value of other net assets (liabilities) includes receivables with a fair value of \$106 million. Included within this fair value is an allowance for doubtful trade accounts receivable of \$2 million. Finance lease receivables totaling \$8 million are also included in this total and the gross amount due under these contracts is \$8 million.

Directly attributable acquisition-related costs of \$38 million were incurred in the transaction. These are reported within general and administration expenses in the current period as part of the operating result of the Diagnostics operating segment.

Subsequent to the effective date of the acquisition on February 8, 2008, the RHI Group purchased the remaining shares in Ventana held by third parties to give the RHI Group a 100% interest in Ventana. The cash consideration was \$1,170 million, which has been recorded to equity as a change in ownership interest in subsidiaries.

Mirus acquisition: Effective September 30, 2008 the Group acquired a 100% controlling interest in Mirus Bio Corporation ('Mirus'), a privately owned US biotechnology company based in Madison, Wisconsin. Mirus (now renamed Roche Madison Inc.) focuses on the discovery and development of innovative nucleic acid based technologies, including a proprietary RNAi (ribonucleic acid interference) delivery platform. Mirus is reported as part of the Roche Pharmaceuticals operating segment. The acquisition will further strengthen the Group's research and development pipeline in RNAi therapeutics, which provides the capabilities to target complex diseases such as cancer, respiratory or metabolic disorders. The purchase consideration was \$125 million, paid in cash.

The combined purchase consideration for the acquisition of Mirus has been allocated as shown below.

Mirus acquisition: net assets acquired *in millions of USD*

	Carrying value prior to acquisition	Fair value adjustments	Carrying value upon acquisition
Property, plant and equipment	-	-	-
Intangible assets			
- Product intangibles: not available for use	-	-	-
- Technology intangibles: in use	-	84	84
Deferred income taxes	-	(32)	(32)
Cash	5	-	5
Other net assets (liabilities)	-	-	-
Net identifiable assets	5	52	57
Goodwill			68
Purchase consideration			125

Goodwill represents a control premium and synergies that can be obtained from the Group's existing business. None of the goodwill recognized is expected to be deductible for income tax purposes.

Directly attributable transaction costs of \$1 million were incurred in the transaction. These are reported within general and administration expenses in the current period as part of the operating result of the Roche Pharmaceuticals operating segment.

Acquisitions – 2008: impact on results *in millions of USD*

	Revenues from external customers	Inventory fair value adjustment	Amortization of intangible assets	Operating profit	Net income
Impact on reported results					
Mirus	-	-	(2)	(3)	(2)
Pharmaceuticals Division	-	-	(2)	(3)	(2)
Ventana	324	(31)	(68)	(40)	(25)
Diagnostics Division	324	(31)	(68)	(40)	(25)
RHI Group	324	(31)	(70)	(43)	(27)
Estimated impact on results if acquisition assumed effective January 1, 2008					
Mirus	-	-	(8)	(12)	(7)
Pharmaceuticals Division	-	-	(8)	(12)	(7)
Ventana ^{a)}	347	-	(74)	(1)	-
Diagnostics Division	347	-	(74)	(1)	-
RHI Group	347	-	(82)	(13)	(7)

The above figures exclude directly attributable transaction costs of \$1 million related to Mirus and of \$38 million to Ventana. Corresponding tax impacts are also excluded.

a) The above figures exclude inventory fair value adjustments of \$31 million and integration costs of \$14 million related to Ventana. Corresponding tax impacts are also excluded.

Acquisitions – 2008: net cash outflow *in millions of USD*

	Cash consideration paid	Cash in acquired company	Net cash outflow
Ventana	(2,294)	41	(2,253)
Mirus	(125)	5	(120)
Total	(2,419)	46	(2,373)

The above cash consideration paid for Ventana does not include the subsequent payment of \$1,170 million to purchase the remaining shares in Ventana held by third parties to give the RHI Group a 100% interest in Ventana. This is reported as financing cash flow in the cash flow statement within the heading 'Change in ownership in subsidiaries'.

Future acquisitions: The RHI Group has announced a minor business combination which is expected to be completed in the first half of 2009, subject to shareholder approval and regulatory clearance as appropriate. The expected purchase consideration, excluding transaction costs, is estimated at approximately \$45 million in cash. Funds will be provided from RHI Group's cash on hand at the time of closing.

Acquisitions – 2007

Tanox: Effective August 2, 2007, Genentech acquired a 100% controlling interest in Tanox, Inc. ('Tanox'), a publicly owned U.S. company that had been listed on the NASDAQ under the symbol 'TNOX'. Tanox is a biotechnology company based in Houston, Texas, that specializes in the discovery and development of biotherapeutics based on monoclonal antibody technology. Genentech and Tanox have been working together in collaboration with Novartis

since 1996 to develop and commercialize Xolair. The purchase consideration was \$933 million, which consisted of \$925 million of cash and \$8 million of directly attributable costs. This has been allocated as follows:

Tanox acquisition: net assets acquired *in millions of USD*

	Carrying value prior to acquisition	Fair value adjustments	Carrying value upon acquisition
Property, plant and equipment	11	-	11
Intangible assets			
- Product intangibles: in use	-	509	509
- Product intangibles: not available for use	-	77	77
Deferred income taxes	7	(207)	(200)
Cash	100	-	100
Marketable securities	102	-	102
Other net assets (liabilities)	15	26	41
Net identifiable assets	235	405	640
Goodwill			293
Purchase consideration			933

Goodwill represents assets that cannot be recognized separately and measured reliably, such as early-stage research projects. It also represents the premium paid over the traded market price to obtain control of the business.

Other acquisitions: Effective March 28, 2007 the RHI Group acquired a 100% controlling interest in Therapeutic Human Polyclonals, Inc. ("THP"), previously a privately owned U.S. biotechnology company based in California and Germany. THP is reported as part of the Roche Pharmaceuticals operating segment. The purchase consideration paid was \$56 million in cash.

Effective May 25, 2007 the RHI Group acquired a 100% controlling interest in 454 Life Sciences, formerly a majority-owned U.S. subsidiary of CuraGen Corporation. 454 Life Sciences develops and commercialises novel instrumentation for high-throughput DNA sequencing and is based in Branford, Connecticut. 454 Life Sciences is reported as part of the Diagnostics operating segment. The purchase consideration paid was \$154 million in cash, which consisted of \$153 million cash and \$1 million of directly attributable costs.

Effective August 8, 2007 the RHI Group acquired a 100% controlling interest in NimbleGen Systems, Inc. ("NimbleGen"), a privately owned U.S. company. NimbleGen develops and commercialises high density DNA microarrays and is based in Madison, Wisconsin. NimbleGen is reported as part of the Diagnostics operating segment. The purchase consideration was \$264 million in cash.

The combined purchase consideration for other acquisitions has been allocated as shown below.

Other acquisitions: net assets acquired *in millions of USD*

	Carrying value prior to acquisition	Fair value adjustments	Carrying value upon acquisition
Property, plant and equipment	10	(1)	9
Intangible assets			
- Product intangibles: in use	16	168	184
- Product intangibles: not available for use	-	8	8
- Technology intangibles	-	28	28
Deferred income taxes	-	(36)	(36)
Cash	20	-	20
Other net assets (liabilities)	(7)	2	(5)
Net identifiable assets	39	169	208
Goodwill			266
Purchase consideration			474

Goodwill represents assets that cannot be recognised separately and measured reliably, such as early-stage research projects, a control premium and synergies that can be obtained from RHI's existing business.

Acquisitions 2007: net cash outflow *in millions of USD*

	Cash consideration paid	Cash in acquired company	Net cash outflow
Tanox	(933)	100	(833)
Other acquisitions	(474)	20	(454)
Total	(1,407)	120	(1,287)

7. Changes in RHI Group organization

As described in Note 3, on July 21, 2008 the Group announced an offer to purchase all outstanding shares of Genentech. Following the closing of a transaction, Genentech's South San Francisco site would become the headquarters of the Group's combined pharmaceuticals operations in the United States. On July 21, 2008 the Group also announced that the Roche Pharmaceuticals business in the U.S. would close manufacturing operations at its site in Nutley, New Jersey, and commercial operations would be moved to Genentech. The research site at Palo Alto, California, would be closed with the research activities being transferred to Nutley and to Genentech.

The current status of the offer is described in Note 3. During 2008 significant costs were incurred in connection with the proposed Genentech transaction and the U.S. reorganization, as described below. These are disclosed separately in the income statement due to the materiality of the amounts and in order to fairly present the RHI Group's results. Costs of other restructuring programs that are less material and do not fundamentally change the RHI Group's organization are expensed in the current period and reported within general and administration expenses.

Changes in RHI Group organization *in millions of USD*

	2008
Roche Pharmaceuticals operating segment	
- U.S. reorganization costs	138
Total Roche Pharmaceuticals operating segment	138
Genentech operating segment	
- Genentech Employee Retention Program expenses	87
Total Genentech operating segment	87
Total Pharmaceuticals Division	225

The total income tax benefit recorded in respect of changes in RHI Group organization was \$86 million (see Note 5).

Roche Pharmaceuticals U.S. reorganization: During 2008 costs were incurred as shown in the table below which are independent of the completion of the proposed Genentech transaction. These mainly relate to the closure of the Palo Alto site and the closure of manufacturing at the Nutley site, but also include costs associated with the reorganization including the transfer of the research operations from Palo Alto and other activities.

Roche Pharmaceuticals U.S. reorganization costs *in millions of USD*

	2008
Employee-related costs	
- Termination costs	91
- Pensions and other post-employment benefits: curtailment	(11)
- Retention plans and other employee benefits	14
- Other employee-related costs	6
Total employee-related costs	100
Site closure costs	
- Impairment of property, plant and equipment	9
- Accelerated depreciation of property, plant and equipment	25
- Other site closure costs	4
Total site closure costs	38
Other reorganization expenses	-
Total US reorganization costs	138

Genentech Employee Retention Program: On August 18, 2008 Genentech announced a broad-based employee retention program, consisting of two retention plans that together cover substantially all employees of the company. The program is estimated to cost approximately \$375 million payable in cash and is being implemented in lieu of Genentech's 2008 annual stock option grant. The timing of the payments related to this program will depend on the outcome of the Roche Proposal. If a merger of Genentech with Roche or an affiliate of Roche has not occurred on or before June 30, 2009, Genentech will pay the retention bonus at that time in accordance with the terms of the program. The costs of the retention program are currently recognized on a straight-line basis over the period from August 18, 2008 to June 30, 2009. If a merger of Genentech with Roche or an affiliate of Roche has occurred on or before June 30, 2009, then the timing of the payments and the recognition of the expense will depend on the terms of the merger. During 2008, total costs for the retention program were \$162 million, of which \$135 million were expensed and \$27 million were capitalized into inventory, which will be recognized as cost of sales as products manufactured after the initiation of the retention program are sold. If Genentech had granted an annual stock option award, as in previous years, with the same total value as the retention program then the costs would have been expensed over the four year vesting period and the amount expensed in 2008 would have been approximately \$48 million. Accordingly the additional incremental costs incurred in 2008 for the retention plan are reported as part of changes in Group organization, since these are directly attributable to the announcement of the Roche Proposal.

Genentech Employee Retention Program expenses *in millions of USD*

	2008
Marketing and distribution	13
Research and development	24
General and administration	11
Total included in operating profit before exceptional items	48
Changes in RHI Group organization	87
Total Genentech Employee Retention Program expenses	135

8. Employee benefits

Employee remuneration *in millions of USD*

	2008	2007
Wages and salaries	3,046	2,773
Social security costs	206	185
Defined contribution post-employment plans	132	129
Operating expenses for defined benefit post-employment plans ⁹	85	102
Equity compensation plans ¹⁰	393	443
Genentech Employee Retention Program ⁷	135	-
Termination costs – Roche Pharmaceuticals US reorganization ⁷	91	-
Other employee benefits	312	283
Employees' remuneration included in operating results	4,400	3,915
Expected return on plan assets for defined benefit post-employment plans ⁹	(260)	(243)
Interest cost for defined benefit post-employment plans ⁹	214	196
Total employees' remuneration	4,354	3,868

Other employee benefits consist mainly of life insurance schemes and certain other insurance schemes providing medical coverage and other long-term and short-term disability benefits. The charges for employee benefits in the operating results are included in the relevant expenditure line by function. The expected return on plan assets and interest costs from defined benefit plans are included as part of financial income and financing costs, respectively (see Note 4).

9. Pensions and other post-employment benefits

The RHI Group's objective is to provide attractive and competitive post-employment benefits to employees, while at the same time ensuring that the various plans are appropriately financed and managing any potential impacts on RHI's long-term financial position. Most employees are covered by pension plans sponsored by RHI Group companies. The nature of such plans varies according to legal regulations, fiscal requirements and economic conditions of the countries in which the employees are employed. Other post-employment benefits consist mostly of post-retirement healthcare and life insurance schemes. Post-employment benefit plans are classified for IFRS as 'defined contribution plans' if the

RHI Group pays fixed contributions into a separate fund or to a third-party financial institution and will have no further legal or constructive obligation to pay further contributions. All other plans are classified as 'defined benefit plans', even if RHI's potential obligation is relatively minor or has a relatively remote possibility of arising. Consequently most of RHI's post-employment benefit plans are classified as 'defined benefit plans' for the purpose of these financial statements.

Defined contribution plans

Defined contribution plans typically consist of payments by employees and by the RHI Group to funds administered by third parties. Payments by the RHI Group were \$132 million (2007: \$129 million). No assets or liabilities are recognized in RHI's balance sheet in respect of such plans, apart from regular prepayments and accruals of the contributions withheld from employees' wages and salaries and of RHI's contributions.

Defined benefit plans

RHI's plans are usually established as trusts independent of the RHI Group and are funded by payments from the RHI Group and by employees. In some cases, the plan is unfunded and the RHI Group pays pensions to retired employees directly from its own financial resources.

Current and past service costs are charged to the appropriate income statement heading within the operating results. Pension plan administration and funding is overseen at a Roche Group corporate level, and any settlement gains and losses resulting from changes in funding arrangements are reported as general and administration expenses within the Corporate segment. The expected returns on plan assets and interest costs are charged to financial income and financing costs, respectively. Actuarial gains and losses are recorded directly in equity. The recognition of pension assets is limited to the total of the present value of any future refunds from the plans or reductions in future contributions to the plans and any cumulative unrecognized past service costs. Adjustments arising from the limit on the recognition of assets for defined benefit plans are recorded directly in equity.

Defined benefit plans: expenses *in millions of USD*

	2008			2007		
	Pension plans	Other post-employment benefit plans	Total	Pension plans	Other post-employment benefit plans	Total
Current service cost	82	15	97	87	15	102
Past service cost	3	7	10	-	-	-
(Gain) loss on curtailment	(19)	(3)	(22)	-	-	-
(Gain) loss on settlement	-	-	-	-	-	-
Total operating expenses	66	19	85	87	15	102
Expected return on plan assets	(222)	(38)	(260)	(209)	(34)	(243)
Interest cost	163	51	214	151	45	196
Total financial (income) expense	(59)	13	(46)	(58)	11	(47)
Total expense recognized in income statement	7	32	39	29	26	55

The funding of RHI's various defined benefit plans is overseen at a Roche Group corporate level. Qualified independent actuaries carry out valuations on a regular basis and for major plans annually as at the balance sheet date. For funded plans, which are usually trusts independent of the Roche Group's finances, the net asset/liability recognized on RHI's balance sheet corresponds to the over/under funding of the plan, adjusted for unrecognized past service costs. For unfunded plans, where the RHI Group meets the pension obligations directly from its own financial resources, a liability for the defined benefit obligation is recorded in RHI's balance sheet. Pension assets and liabilities in different defined benefit plans are not offset unless the RHI Group has a legally enforceable right to use the surplus in one plan to settle obligations in the other plan. Amounts recognized in the balance sheet for post-employment benefits are predominantly non-current and are reported in non-current assets and liabilities.

Defined benefit plans: funding status at December 31, in millions of USD

	2008			2007		
	Funded plans	Unfunded plans	Total	Funded plans	Unfunded plans	Total
Fair value of plan assets	2,259	-	2,259	3,107	-	3,107
Defined benefit obligation	(3,276)	(315)	(3,591)	(3,169)	(348)	(3,517)
Over (under) funding	(1,017)	(315)	(1,332)	(62)	(348)	(410)
Unrecognized past service costs	-	-	-	-	1	1
Reimbursement rights	72	12	84	88	14	102
Net recognized asset (liability)	(945)	(303)	(1,248)	26	(333)	(307)
Reported as						
- Defined benefit plans	-	-	-	205	-	205
- Reimbursement rights	72	12	84	88	14	102
Post-employment benefit assets	72	12	84	293	14	307
Post-employment benefit liabilities	(1,017)	(315)	(1,332)	(267)	(347)	(614)
Net recognized asset (liability)	(945)	(303)	(1,248)	26	(333)	(307)

Further detailed information on plan assets and the defined benefit obligation is given below.

Defined benefit plans: fair value of plan assets and reimbursement rights in millions of USD

	2008			2007		
	Fair value of plan assets	Reimbursement rights	Total	Fair value of plan assets	Reimbursement rights	Total
At January 1	3,107	102	3,209	2,890	95	2,985
Expected return on plan assets	253	7	260	237	6	243
Actuarial gains (losses)	(990)	(20)	(1,010)	67	3	70
Employer contributions	45	(6)	39	68	(1)	67
Employee contributions	-	-	-	-	-	-
Benefits paid - funded plans	(156)	-	(156)	(155)	-	(155)
Past service cost	-	-	-	-	-	-
Business combinations	-	-	-	-	-	-
Curtailments	-	-	-	-	-	-
Settlements	-	-	-	-	-	-
Other	-	1	1	-	(1)	(1)
At December 31	2,259	84	2,343	3,107	102	3,209
Invested as						
- Shares and other equity instruments			1,437			2,283
- Bonds, debentures and other debt instruments			628			555
- Property			194			216
- Other assets			84			155
Total			2,343			3,209

Defined benefit plans: defined benefit obligation *in millions of USD*

	2008			2007		
	Pension plans	Other post-employment benefit plans	Total	Pension plans	Other post-employment benefit plans	Total
At January 1	2,656	861	3,517	2,650	817	3,467
Current service cost	82	15	97	87	15	102
Interest cost	163	51	214	151	45	196
Employee contributions	-	-	-	-	-	-
Actuarial (gains) losses	(11)	(43)	(54)	(103)	31	(72)
Benefits paid – funded plans	(118)	(38)	(156)	(117)	(38)	(155)
Benefits paid – unfunded plans	(7)	(8)	(15)	(8)	(9)	(17)
Past service cost	3	7	10	-	-	-
Business combinations	-	-	-	-	-	-
Curtailments	(19)	(3)	(22)	-	-	-
Settlements	-	-	-	-	-	-
Other	-	-	-	(4)	-	(4)
At December 31	2,749	842	3,591	2,656	861	3,517
Of which						
- Funded plans	2,618	658	3,276	2,511	658	3,169
- Unfunded plans	131	184	315	145	203	348

Actuarial assumptions

Actuarial assumptions are unbiased and mutually compatible estimates of variables that determine the ultimate cost of providing post-employment benefits. They are set on an annual basis by local management and actuaries and are subject to approval by Roche Group corporate management and the Roche Group's actuaries. Actuarial assumptions consist of demographic assumptions on matters such as mortality and employee turnover, and financial assumptions on matters such as salary and benefit levels, interest rates, return on investments and costs of medical benefits. The RHI Group operates defined benefit plans in many countries and the actuarial assumptions vary based upon local economic and social conditions.

Demographic assumptions: The most significant demographic assumptions relate to mortality rates. The Roche Group's actuaries use mortality tables which take into account historic patterns and expected changes, such as further increases in longevity. The mortality table used for the U.S. was RP2000 projected to 2010.

Rates of employee turnover, disability and early retirement are based on historical behavior within RHI Group companies.

Financial assumptions: These are based on market expectations for the period over which the obligations are to be settled. The ranges of assumptions used in the actuarial valuations of the most significant plans are shown below.

Defined benefit plans: financial actuarial assumptions

	2008		2007	
	Weighted average	Range	Weighted average	Range
Discount rates	6.12%	6.12%	6.38%	6.38%
Expected rates of return on plan assets	8.33%	7.50%-8.50%	8.38%	7.50%-8.50%
Expected rates of salary increases	6.22%	4.50%-6.53%	6.21%	4.50%-6.53%
Medical cost trend rate	8.78%	8.00%-8.80%	9.43%	7.50%-9.60%

Discount rates, which are used to calculate the discounted present value of the defined benefit obligation, are determined with reference to market yields on high quality corporate bonds, or government bonds in countries where there is not a deep market in corporate bonds. The currency and term of the bonds is consistent with the obligation being discounted. The interest cost included in the income statement is calculated by multiplying the discount rate by the defined benefit obligation.

Expected returns on plan assets are based on market expectations of expected returns on the assets in funded plans over the duration of the related obligation. This takes into account the split of the plan assets between equities, bonds, property and other investments. The calculation includes assumptions concerning expected dividend and interest income, realized and unrealized gains on plan assets and taxes and administration costs borne by the plan. These are based on long-term market expectations and the actual performance is continually monitored by Roche Group corporate management. Due to the long-term nature of the obligations, the assumptions used for matters such as returns on investments may not necessarily be consistent with recent historical patterns. The expected return on plan assets included in the income statement is calculated by multiplying the expected rate of return by the fair value of plan assets. The difference between the expected return and the actual return in any twelve month period is an actuarial gain/loss and is recorded directly to equity. The actual return on plan assets was a loss of \$737 million (2007: gain of \$304 million).

Expected rates of salary increases, which are used to calculate the defined benefit obligation and the current service cost included in the income statement, are based on the latest expectation and historical behavior within RHI Group companies.

Medical cost trend rates are used to calculate the defined benefit obligation and the current service cost included in the income statement of post-employment medical plans. These take into account the benefits set out in the plan terms and expected future changes in medical costs. The effect of one percentage point increase or decrease in the medical cost trend rate is shown below.

Defined benefit plans: sensitivity of medical cost trend rate *in millions of USD*

	2008		2007	
	+1%	-1%	+1%	-1%
Current service cost and interest cost	7	(7)	8	(7)
Defined benefit obligation	79	(68)	49	(130)

Funding summary

A five-year summary of the funding status of RHI's defined benefit plans is shown in the table below.

Defined benefit plans: summary of funding status *in millions of USD*

	2008	2007	2006	2005	2004
Funded plans					
- Fair value of plan assets	2,259	3,107	2,890	2,564	2,329
- Defined benefit obligation	(3,276)	(3,169)	(3,115)	(3,044)	(2,797)
- Over (under) funding	(1,017)	(62)	(225)	(480)	(468)
Unfunded plans					
- Defined benefit obligation	(315)	(348)	(352)	(311)	(299)
Increase (decrease) in funding status arising from experience adjustments					
- Fair value of plan assets	(990)	67	201	148	143
- Defined benefit obligation	63	(86)	(84)	31	(53)
Increase (decrease) in funding status arising from changes in actuarial assumptions					
- Fair value of plan assets	-	-	-	-	-
- Defined benefit obligation	(9)	158	92	(157)	(82)

Cash flows

The RHI Group incurred cash flows from its defined benefit plans as shown in the table below.

Defined benefit plans: cash flows *in millions of USD*

	2008	2007
Employer contributions – funded plans	(39)	(67)
Benefits paid – unfunded plans	(15)	(17)
Total cash inflow (outflow)	(54)	(84)

Based on the most recent actuarial valuations, the RHI Group expects that employer contributions for funded plans in 2009 will be approximately \$269 million, which includes an estimated \$250 million of additional contributions. Benefits paid for unfunded plans are estimated to be approximately \$19 million.

Amounts recorded in equity

The actuarial gains and losses recognized in the statement of recognized income and expense were losses of \$956 million (2007: gains of \$142 million). The total amount at December 31, 2008 was an accumulated loss of \$583 million. (2007: accumulated gains of \$373 million).

10. Employee stock options and other equity compensation benefits

The RHI Group operates several equity compensation plans, including separate plans at Genentech. Effective January 1, 2005 RHI adopted IFRS 2: 'Share-based Payment'. Amongst other matters, the standard requires that the fair value of all equity compensation plan awards granted to employees be estimated at grant date and recorded as an expense over the vesting period. The expense is charged against the appropriate income statement heading.

Expenses for equity compensation plans *in millions of USD*

	2008	2007
Cost of sales	62	73
Marketing and distribution	91	109
Research and development	159	170
General and administration	81	91
Total operating expenses	393	443
Share option plans		
Genentech Stock Option Plan	310	361
Other equity compensation plans		
Genentech Employee Stock Purchase Program	31	27
Roche Stock-settled Stock Appreciation Rights	61	51
Roche Performance Share Plan	2	-
Roche Stock Appreciation Rights	(11)	4
Total other equity compensation plans	83	82
Total operating expenses	393	443
of which		
- Equity-settled	404	439
- Cash-settled	(11)	4

Cash inflow (outflow) from equity compensation plans *in millions of USD*

	2008	2007
Share option plans		
Genentech Stock Option Plan	573	340
Other equity compensation plans		
Genentech Employee Stock Purchase Program	107	112
Roche Stock-settled Stock Appreciation Rights	(27)	(49)
Roche Stock Appreciation Rights	(32)	(77)
Total other equity compensation plans	48	(14)
Total cash inflow (outflow)	621	326
of which		
- Equity-settled	653	403
- Cash-settled	(32)	(77)

Roche Long-Term: During 2005 the RHI Group implemented a new global long-term incentive program which is available to certain directors, management and employees selected at the discretion of the RHI Group. The program consists of Stock-settled Stock Appreciation Rights (S-SARs).

Share option plans

Genentech Stock Option Plan: The Genentech Stock Option Plan was adopted in 1999 and amended thereafter. In April 2004 Genentech's shareholders approved an equity incentive plan. The plans allow for the granting of various stock options, incentive stock options and stock purchase rights to employees, directors and consultants of Genentech. No incentive stock options and stock purchase rights have been granted under this plan to date. The options granted, which are non-tradable equity-settled awards, have a duration of 10 years and vest on a phased basis over four years, subject to continued employment.

Genentech Stock Option Plan - movement in number of options outstanding

	Number of options (millions)	2008 Weighted average exercise price (USD)	Number of options (millions)	2007 Weighted average exercise price (USD)
Outstanding at January 1	92	60.94	88	54.53
Granted	1	79.23	18	79.40
Forfeited	(3)	80.52	(4)	76.45
Exercised	(13)	44.83	(10)	32.76
Expired	-	-	-	-
Outstanding at December 31	77	63.06	92	60.94
- of which exercisable	56	56.51	54	48.46

Genentech Stock Option Plan - terms of options outstanding at December 31, 2008

Range of exercise prices (USD)	Number outstanding (millions)	Options outstanding Weighted average years remaining contractual life	Options outstanding Weighted average exercise price (USD)	Options exercisable Number exercisable (millions)	Options exercisable Weighted average exercise price (USD)
6.27 - 8.89	0.2	6.39	6.81	0.2	6.81
10.00 - 14.35	6.2	2.85	13.68	6.2	13.68
15.04 - 22.39	4.5	2.35	20.89	4.5	20.89
22.88 - 33.00	0.1	2.52	26.08	0.1	26.08
35.63 - 53.23	20.3	4.76	47.11	20.3	47.11
53.95 - 75.90	2.0	7.85	68.03	0.9	63.31
75.99 - 98.80	44.1	7.75	81.77	23.8	82.70
Total	77.4	6.25	63.06	56.0	56.51

Other equity compensation plans

Genentech Employee Stock Purchase Program (ESPP): Genentech has an employee stock purchase program that allows employees to purchase Genentech's common stock at 85% of the lower of market value at the grant date or purchase date. In 2008 a total of 1.8 million shares of Genentech common stock were purchased (2007: 1.7 million shares) resulting in a cash inflow of \$107 million (2007: \$112 million). During the year the cost of the plan was \$31 million (2007: \$27 million), which was reported within the relevant expenditure line by function.

Roche Stock-settled Stock Appreciation Rights: With the introduction of Roche Long-Term in 2005, the RHI Group offers Stock-settled Stock Appreciation Rights (S-SARs) to certain directors, management and employees selected at the discretion of the RHI Group. The S-SARs give employees the right to receive non-voting equity securities reflecting the value of any appreciation in the market price of the non-voting equity securities between the grant date and the exercise date. The options, which are non-tradable equity-settled awards, have a seven-year duration and vest on a phased basis over three years, subject to continued employment. The RHI Group covers such obligations by purchasing non-voting equity securities, or derivatives thereon (see Note 27).

Roche S-SARs - movement in number of rights outstanding

	Number of rights (thousands)	2008 Weighted average exercise price (CHF)	Number of rights (thousands)	2007 Weighted average exercise price (CHF)
Outstanding at January 1	4,681	185.14	3,700	156.39
Granted	3,579	193.18	1,766	229.50
Forfeited	(345)	207.42	(144)	178.61
Exercised	(454)	133.07	(747)	144.11
Expired	-	-	(1)	134.29
Transfer of expatriate employees	(85)	173.61	107	151.07
Outstanding at December 31	7,376	191.33	4,681	185.14
- of which exercisable	2,408	171.52	1,226	150.29

Roche S-SARs – terms of rights outstanding at December 31, 2008

Year of grant	Number outstanding (thousands)	Rights outstanding		Rights exercisable	
		Weighted average years remaining contractual life	Weighted average exercise price (CHF)	Number exercisable (thousands)	Weighted average exercise price (CHF)
2005	1,051	3.17	123.62	1,051	123.62
2006	1,284	4.17	195.17	811	195.18
2007	1,582	5.18	229.37	534	229.37
2008	3,459	6.12	193.09	12	195.80
Total	7,376	5.16	191.33	2,408	171.52

The weighted average fair value of the options granted in 2008 was calculated using a binomial model. The resulting weighted average fair value per right is CHF 22.00, giving a total fair value of 79 million Swiss francs which is charged over the vesting period of three years.

Roche Performance Share Plan: The Roche Group offers future non-voting equity security awards (or, at the discretion of the Roche Group Board of Directors, their cash equivalent) to certain directors and key senior managers. The program was established at the beginning of 2002 and was in effect for three years. During 2004 the Roche Group Board of Directors approved a new three-year cycle of the Roche Performance Share Plan (PSP) to operate during 2005-2007. Additional cycles of the PSP with similar conditions were approved to operate during 2006-2008, 2007-2009 and 2008-2010. The terms of these awards are set out in the table below. The amount of non-voting equity securities allocated will depend upon the individual's salary level, the achievement of performance targets linked to the Roche Group's Total Shareholder Return (shares and non-voting equity securities combined) relative to the Roche Group's peers during the three-year period from the date of the grant, and the discretion of the Roche Group Board of Directors. These are non-tradable equity-settled awards. Each award will result in between zero and two non-voting equity securities, depending upon the achievement of the performance targets.

Roche Performance Share Plan – terms of outstanding awards at December 31, 2008

	2006-2008	2007-2009	2008-2010
Number of awards (thousands)	2	9	14
Vesting period	3 years	3 years	3 years
Allocated to recipients in	Feb. 2009	Feb. 2010	Feb. 2011
Fair value per unit (CHF)	210.06	239.49	201.22

The weighted average fair value of the awards granted in 2008 was calculated using a Monte Carlo simulation. The input parameters to the model were the covariance matrix between Roche and the other individual companies of the peer group based on a three-year history and a risk-free rate of 2.97%. The valuation also takes into account the defined rank and performance structure which determines the payout of the PSP.

Roche Stock Appreciation Rights: Some employees of the RHI Group receive Stock Appreciation Rights (SARs) as part of their compensation. The SARs, which are non-tradable cash-settled awards, may be exercised after a vesting period of between one and three years for a cash payment, based upon the amount by which the market price of the Roche Group's American Depositary Receipts (ADRs) at the point of exercise exceeds the strike price (grant price at

issuance). Following the implementation of Roche Long-Term (see above), the RHI Group does not plan to award any further cash-settled SARs and no awards have been made since 2004. On January 9, 2009 the ratio of ADRs to Roche Holding Ltd. non-voting equity securities (*Genussscheine*) was changed from 2:1 to 4:1. The information below has been restated for this change.

Roche Stock Appreciation Rights *in millions of USD*

	2008	2007
Liability at December 31	40	83
Intrinsic value of vested rights at December 31	40	83

Roche Stock Appreciation Rights- terms of rights outstanding at December 31, 2008

Year of grant	Number outstanding and exercisable (thousands)	Rights outstanding and exercisable	
		Expiry	Weighted average exercise price (USD)
2003	798	Feb. 2010	14.41
2004	1,694	Feb. 2011	26.04
Total	2,492		22.31

The fair value at December 31, 2008 was calculated using a binomial model. The inputs to the model were the ADR price at December 31, 2008 (\$76.55). The exercise price and other inputs are given in the table below.

Issues of share options in 2008: Issues of share options in 2008, including the methodology used to calculate fair value and the main inputs to the valuation models, are described below.

Issues of equity compensation plans in 2008

	Genentech Stock Option Plan	Roche S-SAR
Number of options granted	1 million	3,579 thousand
Underlying equity	Genentech common stock	Roche non-voting equity securities
Currency	US dollars	Swiss francs
Vesting period	Progressively over 4 years	Progressively over 3 years
Contractual life	10 years	7 years
Weighted average fair value of options issued	22.39	22.00
Option pricing model used	Binomial	Binomial
Inputs to option pricing model		
- Share price at grant date	79.23	193.18
- Exercise price	79.23	193.18
- Expected volatility	24.1%	24.6%
- Expected dividend yield	0%	7.65%
- Early exercise factor	1.484	1.649
- Expected exit rate	8.6%	8.2%

Volatility for Roche S-SAR was determined primarily by reference to historically observed prices of the underlying equity. Volatility for Genentech options was determined primarily by reference to the implied volatility of Genentech's traded options. Risk-free interest rates are derived from zero coupon swap rates at the grant date taken from Datastream. The early exercise factor describes the ratio between the expected market price at the exercise date and the exercise price at which early exercises can be expected, based on historically observed behavior.

11. Property, plant and equipment

Property, plant and equipment: movements in carrying value of assets *in millions of USD*

	Land	Buildings and land improvements	Machinery and equipment	Construction in progress	Total
At January 1, 2007					
Cost	463	3,366	3,826	1,349	9,004
Accumulated depreciation and impairment	-	(709)	(2,185)	-	(2,894)
Net book value	463	2,657	1,641	1,349	6,110
Year ended December 31, 2007					
At January 1, 2007	463	2,657	1,641	1,349	6,110
Additions	19	79	221	1,078	1,397
Disposals	(1)	(1)	(30)	(17)	(49)
Tanox acquisition ⁶	-	-	-	11	11
Other business combinations ⁶	-	1	6	2	9
Transfers	-	308	291	(599)	-
Depreciation charge	-	(140)	(339)	-	(479)
Impairment charge	-	-	(1)	-	(1)
Other	-	-	3	17	20
At December 31, 2007	481	2,904	1,792	1,841	7,018
Cost	481	3,747	4,193	1,841	10,262
Accumulated depreciation and impairment	-	(843)	(2,401)	-	(3,244)
Net book value	481	2,904	1,792	1,841	7,018
Year ended December 31, 2008					
At January 1, 2008	481	2,904	1,792	1,841	7,018
Additions	10	67	131	917	1,125
Disposals	-	(3)	(20)	(10)	(33)
Ventana acquisition ⁶	14	22	23	27	86
Transfers	-	1,225	576	(1,801)	-
Depreciation charge	-	(267)	(297)	-	(564)
Impairment charge	-	(9)	(8)	-	(17)
At December 31, 2008	505	3,939	2,197	974	7,615
Cost	505	5,054	4,799	974	11,332
Accumulated depreciation and impairment	-	(1,115)	(2,602)	-	(3,717)
Net book value	505	3,939	2,197	974	7,615

Impairment charges arise from changes in the estimates of the future cash flows expected to result from the use of the asset and its eventual disposal. Factors such as changes in the planned use of buildings, machinery or equipment, or closure of facilities, the presence or absence of competition and technical obsolescence could result in shortened useful lives or impairment. Impairment charges of \$8 million (2007: \$1 million) were reported as part of 'Cost of sales' and impairment charges of \$9 million (2007: zero) are reported as part of 'Changes in RHI Group organization' (see Note 7).

Borrowing costs totaling \$38 million using a rate of 4.79% (2007: \$40 million using a rate of 4.79%) were capitalized as property, plant and equipment.

Leasing arrangements where the RHI Group is the lessee

Finance leases: As at December 31, 2008 Genentech had leasing arrangements which are described in Note 3. There was no other capitalized cost of property, plant and equipment under finance leases (2007: none).

Operating leases: RHI Group companies are party to a number of operating leases, mainly for plant and machinery, including motor vehicles, and for certain short-term property rentals. The arrangements do not impose any significant restrictions on the RHI Group. Total operating lease rental expense was \$86 million (2007: \$78 million).

Operating leases: future minimum lease payments under non-cancellable leases in millions of USD

	2008	2007
Within one year	59	61
Between one and five years	114	115
More than five years	73	68
Total minimum payments	246	244

Leasing arrangements where the RHI Group is the lessor

Finance leases: Certain assets, mainly diagnostics instruments, are leased to third parties through finance lease arrangements. Such assets are reported as receivables at an amount equal to the net investment in the lease. Lease income from finance leases is recognized over the term of the lease based on the effective interest rate method.

Finance leases: future minimum lease payments under non-cancellable leases in millions of USD

	Gross investment in lease		Present value of future minimum lease payments	
	2008	2007	2008	2007
Within one year	17	16	13	13
Between one and five years	23	23	19	18
More than five years	-	-	-	-
Total	40	39	32	31
Unearned finance income	(4)	(4)	n/a	n/a
Unguaranteed residual value	n/a	n/a	4	4
Net investment in lease	36	35	36	35

The accumulated allowance for uncollectible minimum lease payments was \$1 million (2007: \$1 million). There were no contingent rents recognized in income.

Operating leases: Certain assets, mainly some diagnostics instruments, are leased to third parties through operating lease arrangements. Such assets are reported within property, plant and equipment. Lease income from operating leases is recognized over the lease term on a straight line basis.

Operating leases: future minimum lease payments under non-cancellable leases in millions of USD

	2008	2007
Within one year	60	55
Between one and five years	132	123
More than five years	-	-
Total minimum payments	192	178

At December 31, 2008, machinery and equipment with an original cost of \$220 million (2007: \$197 million) and a net book value of \$121 million (2007: \$112 million) was being leased to third parties. There was no contingent rent recognized as income.

Capital commitments

The RHI Group has non-cancellable capital commitments for the purchase or construction of property, plant and equipment totaling \$1,393 million (2007: \$1,415 million). In addition, Genentech's capital commitments in respect of its manufacturing agreements with Lonza and its leasing arrangements are described in Note 3.

12. Goodwill

Goodwill: movements in carrying value of assets *in millions of USD*

	2008	2007
At January 1	2,442	1,883
Tanox acquisition ⁶		293
Ventana acquisition ⁶	1,586	-
Mirus acquisition ⁶	68	266
Impairment charge	-	-
At December 31	4,096	2,442
Allocated to the following cash-generating units		
Pharmaceuticals Division		
- Roche Pharmaceuticals	102	33
- Genentech	1,668	1,668
Total Pharmaceuticals Division	1,770	1,701
Diagnostics Division		
- Diabetes Care	2	2
- Professional Diagnostics	34	34
- Molecular Diagnostics	-	-
- Applied Science	233	233
- Tissue Diagnostics	755	-
- Strategic goodwill (held at divisional level and not allocated to business areas)	1,302	472
Total Diagnostics Division	2,326	741
Total RHI Group	4,096	2,442

There are no accumulated impairment losses in goodwill.

Goodwill impairment testing

Pharmaceuticals Division: The division's reportable operating segments are the cash-generating units used for the testing of goodwill. For Genentech, the recoverable amount is based on fair value less costs to sell, determined with reference to the publicly quoted share price of Genentech's shares. The goodwill in Roche Pharmaceuticals is not significant in comparison with RHI's total carrying value of goodwill.

Diagnostics Division: The division's business areas are the cash-generating units used for the testing of goodwill. The goodwill arising from the Corange/Boehringer Mannheim acquisition and part of the goodwill from the Ventana acquisition is recorded and monitored at a divisional level as it relates to the strategic development of the whole division and cannot be meaningfully allocated to the division's business areas. Therefore the cash-generating unit for this goodwill is the entire division. The recoverable amount used in the impairment testing is based on value in use. The cash flow projections used are based on the most recent business plans approved by management. These assume no significant changes in the organization of the division and include management's latest estimates on sales volume and pricing, and production and other operating costs. These reflect past experience and are projected over five years. The estimates for the Tissue Diagnostics business area are projected over ten years, which management believes reflects the long-term nature of this business. The cash flow projections used do not extend beyond management's most recent business plans. The discount rate used is based on a rate of 8.4%, which is derived from a capital asset pricing model using data from Swiss capital markets, including Swiss Federal Government ten-year bonds and the Swiss Market Index. A weighted average tax rate of 19.7% is used in the calculations. Management believes that any reasonably possible change in any of the key assumptions would not cause the carrying value of goodwill to exceed the recoverable amount.

13. Intangible assets

Intangible assets: movements in carrying value of assets *in millions of USD*

	Product intangibles: in use	Product intangibles: not available for use	Technology intangibles: in use	Total
At January 1, 2007				
Cost	3,092	284	564	3,940
Accumulated amortization and impairment	(2,290)	-	(484)	(2,774)
Net book value	802	284	80	1,166
Year ended December 31, 2007				
At January 1, 2007	802	284	80	1,166
Tanox acquisition ⁶	509	77	-	586
Other business combinations ⁶	184	8	28	220
Additions	42	554	1	597
Disposals	(52)	(224)	(22)	(298)
Amortization charge	(255)	-	(23)	(278)
Impairment charge	-	(39)	-	(39)
At December 31, 2007	1,230	660	64	1,954
Cost	3,772	660	571	5,003
Accumulated amortization and impairment	(2,542)	-	(507)	(3,049)
Net book value	1,230	660	64	1,954
Allocation by operating segment				
- Roche Pharmaceuticals	16	295	7	318
- Genentech	848	361	31	1,240
- Diagnostics	366	4	26	396
Total RHI Group	1,230	660	64	1,954
Year ended December 31, 2008				
At January 1, 2008	1,230	660	64	1,954
Ventana acquisition ⁶	742	516	-	1,258
Mirus acquisition ⁶	-	-	84	84
Additions	43	432	-	475
Disposals	(25)	(58)	-	(83)
Amortization charge	(278)	-	(27)	(305)
Impairment charge	-	(39)	-	(39)
At December 31, 2008	1'712	1,511	121	3,344
Cost	4,534	1,540	655	6,729
Accumulated amortization and impairment	(2,822)	(29)	(534)	(3,385)
Net book value	1,712	1,511	121	3,344
Allocation by operating segment				
- Roche Pharmaceuticals	6	447	88	541
- Genentech	732	544	10	1,286
- Diagnostics	974	520	23	1,517
Total RHI Group	1'712	1,511	121	3,344

Significant intangible assets as at December 31, 2008 in millions of USD

	Operating segment	Net book value	Remaining amortization period
Product intangibles in use			
Tanox acquisition	Genentech	449	11 years
Ventana acquisition	Diagnostics	674	9 years
Product intangibles not available for use			
Ventana acquisition	Diagnostics	516	n/a

Classification of amortization and impairment expenses in millions of USD

	2008		2007	
	Amortization	Impairment	Amortization	Impairment
Cost of sales				
- Pharmaceuticals	166	-	213	-
- Diagnostics	112	-	42	-
Research and development				
- Pharmaceuticals	24	39	21	39
- Diagnostics	3	-	2	-
Total	305	39	278	39

Internally generated intangible assets

The RHI Group currently has no internally generated intangible assets from development as the criteria for the recognition as an asset are not met.

Intangible assets with indefinite useful lives

The Group currently has no intangible assets with indefinite useful lives.

Impairment of intangible assets

Impairment charges arise from changes in the estimates of the future cash flows expected to result from the use of the asset and its eventual disposal. Factors such as the presence or absence of competition, technical obsolescence or lower than anticipated sales for products with capitalized rights could result in shortened useful lives or impairment.

2008: In the Roche Pharmaceuticals operating segment an impairment charge of \$10 million was recorded in the first half of 2008 and a further \$29 million were recorded in the second half of 2008. These relate to product intangibles not available for use and follow from decisions to terminate development of three compounds with alliance partners. The assets concerned, which were not yet being amortized, were fully written-down by these charges.

2007: In the Genentech operating segment an impairment charge of \$35 million was recorded in the second half of 2007, which was resulted from a decision to terminate development of compounds with two alliance partners. In the Roche Pharmaceuticals operating segment an impairment charge of \$4 million was recorded in the first half of 2007, which relates to a decision to terminate development of one compound with an alliance partner. The assets concerned, which were not yet being amortized, were fully written-down by these charges.

Potential commitments from alliance collaborations

The RHI Group is party to in-licensing and similar arrangements with its alliance partners. These arrangements may require the RHI Group to make certain milestone or other similar payments dependent upon the achievement of agreed objectives or performance targets as defined in the collaboration agreements.

RHI's current estimate of future third party commitments for such payments is set out in the table below. These figures are not risk adjusted, meaning that they include all such potential payments that can arise assuming all projects currently in development are successful. The timing is based on RHI's current best estimate. These figures do not include any potential commitments within the RHI Group, such as may arise between the Roche Pharmaceuticals and Genentech businesses.

Potential future third-party collaboration payments as at December 31, 2008 in millions of USD

	Pharmaceuticals	Diagnostics	RHI Group
Within one year	75	1	76
Between one and two years	110	6	116
Between two and three years	108	1	109
Total	293	8	301

14. Associates

The RHI Group has no investments in associates (2007: none).

15. Financial and other long-term assets**Financial and other long-term assets in millions of USD**

	2008	2007
Available-for-sale investments	331	458
Held-to-maturity investments	15	17
Loans receivable	3	-
Long-term trade receivables	1	67
Restricted cash	-	-
Other	21	22
Total financial long-term assets	371	564
Long-term employee benefits	212	241
Other	110	139
Total other long-term assets	322	380

Financial long-term assets are held for strategic purposes and are classified as non-current. The available-for-sale investments are mainly equity investments. Unquoted equity investments classified as available-for-sale are generally measured at cost, as their fair value cannot be measured reliably. These are primarily investments in private biotechnology companies, which are kept as part of RHI's strategic alliance efforts. The carrying value of equity investments held at cost is \$24 million (2007: \$23 million). The average effective interest rate of held-to-maturity investments is 2.5% (2007: 4.4%). Loans receivable comprise all loans to third parties with a term of over one year.

16. Inventories**Inventories in millions of USD**

	2008	2007
Raw materials and supplies	240	233
Work in process	889	1,005
Finished goods and intermediates	970	1,004
Less: provision for slow-moving and obsolete inventory	(93)	(35)
Total inventories	2,006	2,207

In 2008 expenses relating to inventories expensed through cost of sales totaled \$3,578 million (2007: \$3,324 million).

17. Accounts receivable

Accounts receivable in millions of USD

	2008	2007
Trade accounts receivable	1,906	2,070
Less: allowances	(81)	(85)
Total accounts receivable	1,825	1,985

Net bad debt expense was \$3 million (2007: \$1 million). Significant concentrations within trade receivables of counterparty credit risk are described in Note 30.

18. Other current assets

Other current assets in millions of USD

	2008	2007
Accrued interest income	1	1
Derivative financial instruments ²³	79	33
Restricted cash	-	788
Other	353	339
Total financial current assets	433	1,161
Prepaid expenses	177	122
Other	17	17
Total non-financial current assets	194	139
Total other current assets	627	1,300

Restricted cash in 2007 includes \$788 million of the surety bond posted by Genentech in connection with the City of Hope litigation (see Note 24). Following the settlement of this litigation the entirety of the pledged amount became unrestricted cash and available for use in Genentech's operations during the third quarter of 2008.

19. Marketable securities

Marketable securities in millions of USD

	2008	2007
Financial assets at fair-value-through-profit-or-loss		
Held-for-trading investments		
- Bonds and debentures	971	1,002
Total financial assets at fair-value-through-profit-or-loss	971	1,002
Available-for-sale financial assets		
- Shares	33	150
- Bonds and debentures	3,732	1,993
- Money market instruments and time accounts over three months	1,646	1,492
Total available-for-sale financial assets	5,411	3,635
Total marketable securities	6,382	4,637

Marketable securities are held for fund management purposes and are classified as current. Other investments held for strategic purposes are classified as non-current (see Note 15).

Shares: These consist primarily of readily saleable equity securities.

Bonds and debentures: The carrying values, contract maturity and average effective interest rate of debt securities is shown below.

Bonds and debentures *in millions of USD*

Contracted maturity	2008		2007	
	Amount	Average effective interest rate	Amount	Average effective interest rate
Within one year	1,643	5.11%	1,321	5.58%
Between one and five years	2,443	5.00%	1,476	4.91%
More than five years	617	5.00%	198	5.63%
Total bonds and debentures	4,703	5.03%	2,995	5.25%

Money market instruments: These generally have fixed interest rates ranging from 0.05% to 4.53% (2007: 3.08% to 6.13%). They are contracted to mature within one year of December 31, 2008.

20. Cash and cash equivalents**Cash and cash equivalents** *in millions of USD*

	2008	2007
Cash		
- Cash in hand and in current or call accounts	262	239
Cash equivalents		
- Time accounts with a maturity of three months or less	2,648	803
Total cash and cash equivalents	2,910	1,042

21. Accounts payable**Accounts payable** *in millions of USD*

	2008	2007
Trade accounts payable	385	550
Other taxes payable	76	40
Other accounts payable	65	64
Total accounts payable	526	654

22. Accrued and other current liabilities**Accrued and other current liabilities** *in millions of USD*

	2008	2007
Deferred income	67	111
Accrued payroll and related items	875	632
Interest payable	60	60
Derivative financial instruments ²³	31	19
Other accrued liabilities	2,099	2,007
Total accrued and other current liabilities	3,132	2,829

23. Derivative financial instruments

The RHI Group uses derivative financial instruments as part of its risk management and trading strategies. This is discussed in Note 30. Derivative financial instruments are carried at fair value. The methods used for determining fair value are described in Note 1.

Derivative financial instruments *in millions of USD*

	Assets		Liabilities	
	2008	2007	2008	2007
Foreign currency derivatives				
- Forward exchange contracts and swaps	-	-	(31)	(15)
- Other	20	-	-	-
Interest rate derivatives				
- Swaps	19	7	-	-
- Other	-	-	-	-
Other derivatives	40	26	-	(4)
Total derivative financial instruments ^{18, 22}	79	33	(31)	(19)

Hedge accounting

The RHI Group's accounting policy on hedge accounting, which is described in Note 1, requires that to qualify for hedge accounting the hedging relationship must meet several strict conditions on documentation, probability of occurrence, hedge effectiveness and reliability of measurement.

As described in Note 30, the RHI Group has financial risk management policies for foreign exchange risk, interest rate risk, market risk, credit risk and liquidity risk. When deemed appropriate, certain of the above risks are managed through the use of derivatives. While many of these transactions can be considered as hedges in economic terms, if the required conditions are not met, then the relationship does not qualify for hedge accounting. In this case the hedging instrument and the hedged item are reported independently as if there were no hedging relationship, which means that any derivatives are reported at fair value, with changes in fair value included in financial income.

The RHI Group generally limits the use of hedge accounting to certain significant transactions. Consequently as at December 31, 2008 the RHI Group has no fair value hedges, cash flow hedges or hedges of net investment in a foreign entity that meet the strict requirements to qualify for hedge accounting, apart from those described below.

The RHI Group has hedged some of its fixed-term debt instruments with interest rate swaps. As at December 31, 2008 such instruments, which have been designated and qualify as fair value hedges, are recorded in the balance sheet as an asset with a fair value of \$19 million (2007: asset of \$7 million). During 2008 a gain of \$13 million was recorded on these interest rate swaps (2007: gain of \$17 million). As the fair value hedge has been highly effective since inception, the result of the interest rate swaps is largely offset by changes in the fair value of the hedged debt instrument.

Genentech has non-U.S. dollar cash flows from future royalty income and development expenses expected over the next one to five years. To hedge part of this foreign exchange risk Genentech enters into derivative financial instruments such as options and forward contracts. Genentech has equity investments in various biotechnology companies that are subject to a greater risk of market fluctuation than the stock market in general. To manage part of this exposure Genentech enters into derivative financial instruments such as zero cost collars and forward contracts. As at December 31, 2008 such instruments, which are designated and qualify for hedge accounting, are recorded as assets with a fair value of \$40 million (2007: assets of \$24 million). These matters are also described in Genentech's annual report and quarterly SEC filings.

Movements on the fair value reserve for designated cash flow hedges are included in Note 27.

24. Provisions and contingent liabilities

Provisions: movements in recognized liabilities *in millions of USD*

	Legal provisions	Environmental provisions	Restructuring provisions	Employee provisions	Other provisions	Total
Year ended December 31, 2007						
At January 1, 2007	841	74	17	97	146	1,175
Additional provisions created	87	27	26	67	126	333
Unused amounts reversed	(13)	(1)	(7)	(2)	(2)	(25)
Utilized during the year	(48)	(6)	(10)	(41)	(111)	(216)
Unwinding of discount ⁴	54	2	-	-	-	56
At December 31, 2007	921	96	26	121	159	1,323
Of which						
- Current portion	852	12	25	27	157	1,073
- Non-current portion	69	84	1	94	2	250
Total provisions	921	96	26	121	159	1,323
Year ended December 31, 2008						
At January 1, 2008	921	96	26	121	159	1,323
Additional provisions created	57	2	119	69	229	476
Unused amounts reversed	(315)	(3)	(6)	(8)	(7)	(339)
Utilized during the year	(552)	(5)	(22)	(40)	(161)	(780)
Unwinding of discount ⁴	15	3	-	-	-	18
Other	-	-	4	-	-	4
At December 31, 2008	126	93	121	142	220	702
Of which						
- Current portion	53	14	104	50	206	427
- Non-current portion	73	79	17	92	14	275
Total provisions	126	93	121	142	220	702
Expected outflow of resources						
- Within one year	53	14	104	50	206	427
- Between one to two years	24	11	5	62	-	102
- Between two to three years	16	6	12	1	11	46
- More than three years	33	62	-	29	3	127
Total provisions	126	93	121	142	220	702

Major legal cases

Income (expense) from major legal cases is disclosed separately in the income statement due to the materiality of the amounts and in order to fairly present the Group's results. Income of \$250 million was recorded in 2008 following the April 24, 2008 California Supreme Court decision in the City of Hope litigation (see below). This consists of the \$310 million released to income as a favorable litigation settlement, net of amounts recorded in respect of final settlement negotiations with the City of Hope National Medical Center. Costs of other litigation matters that are less material are expensed in the current period and reported within general and administration expenses. The total income tax expense recorded in respect of major legal cases was \$98 million (see Note 5).

Legal provisions

Legal provisions consist of a number of separate legal matters, including claims arising from trade, in various RHI Group companies. The majority of any cash outflows for these other matters are expected to occur within the next one to three years, although these are dependent on the development of the various litigations. Significant provisions are discounted between 4% and 5% where the time value of money is material.

Environmental provisions

Provisions for environmental matters include various separate environmental issues. By their nature the amounts and timing of any outflows are difficult to predict. The estimated timings of these cash outflows are shown in the table above. Significant provisions are discounted by between 7% and 8% where the time value of money is material.

Restructuring provisions

These arise from planned programs that materially change the scope of business undertaken by the RHI Group or the manner in which business is conducted. Such provisions include only the costs necessarily entailed by the restructuring which are not associated with the recurring activities of the RHI Group. The timings of these cash outflows are reasonably certain and are shown in the table above. These provisions are not discounted as the time value of money is not material in these matters.

Employee provisions

These mostly relate to certain employee benefit obligations, such as sabbatical leave and long-service benefits. The timings of these cash outflows can be reasonably estimated based on past performance and are shown in the table above. These provisions are not discounted as the time value of money is not material in these matters.

Other provisions

Other provisions consist mostly of claims arising from trade, sales returns, certain employee benefit obligations and various other provisions from RHI Group companies that do not fit into the above categories. The timings of cash outflows are by their nature uncertain and the best estimates are shown in the table above. These provisions are not discounted as the time value of money is not material in these matters.

Contingent liabilities

The operations and earnings of the RHI Group continue, from time to time and in varying degrees, to be affected by political, legislative, fiscal and regulatory developments, including those relating to environmental protection. The industries in which the RHI Group operates are also subject to other risks of various kinds. The nature and frequency of these developments and events, not all of which are covered by insurance, as well as their effect on future operations and earnings, are not predictable.

The RHI Group has entered into strategic alliances with various companies in order to gain access to potential new products or to utilize other companies to help develop the RHI Group's own potential new products. Potential future payments may become due to certain collaboration partners achieving certain milestones as defined in the collaboration agreements. RHI's best estimate for future commitment payments are given in Note 13.

Roche Pharmaceuticals legal cases

Hoffmann-La Roche Inc. ("HLR") and various other Roche affiliates have been named as defendants in numerous legal actions in the United States relating to the acne medication Accutane. The litigation alleges that Accutane caused certain serious conditions, including, but not limited to, inflammatory bowel disease ("IBD"), birth defects and psychiatric disorders. As of December 31, 2008 HLR is defending approximately 560 actions brought in various federal and state courts throughout the United States for personal injuries allegedly resulting from their use of Accutane. Most of the actions allege IBD as a result of Accutane use.

All of the actions pending in federal court alleging IBD were consolidated for pre-trial proceedings in a Multi-District Litigation in the United States District Court for the Middle District of Florida, Tampa Division. In July 2007 the District Court granted summary judgment in favor of HLR in the lead federal IBD cases. The plaintiffs appealed and in August 2008 these rulings were affirmed by the United States Court of Appeals for the Eleventh Circuit.

All of the actions pending in state court in New Jersey alleging IBD were consolidated for pre-trial proceedings in the Superior Court of New Jersey, Law Division, Atlantic County. As of December 31, 2008 juries in the Superior Court have ruled in favor of the plaintiff in five cases, assessing total compensatory damages totaling \$26 million. HLR has appealed in one case to the Superior Court of New Jersey, Appellate Division and is reviewing its post-trial option in the other cases.

In October 2007 a jury in the Circuit Court of Escambia County, Florida, returned a verdict in favor of the plaintiff, assessing total compensatory damages of \$7 million, subsequently reduced to \$6.8 million by the court, against the Company. HLR has appealed to the District Court of Appeal, State of Florida.

As of December 31, 2008 the RHI Group has recorded provisions totaling \$96 million in respect of these matters. Additional trials are scheduled for 2009. Individual trial results depend on a variety of factors, including many that are unique to the particular case and therefore the trial results to date may not be predictive of future trial results. The RHI Group continues to defend vigorously the remaining personal injury cases and claims.

Genentech legal cases

On June 10, 2002 Genentech announced that a Los Angeles County Superior Court jury voted to award the City of Hope National Medical Center ('City of Hope') approximately \$300 million in compensatory damages based on a finding of a breach of a 1976 agreement between Genentech and the City of Hope. On June 24, 2002 the jury voted to award the City of Hope \$200 million in punitive damages in the same case. On September 13, 2002 Genentech filed a notice of appeal of the jury verdict and damages awards with the California Court of Appeal. On October 21, 2004 the Court of Appeal affirmed the verdict and damages awards in all respects. Also, on October 21, 2004 Genentech announced that it would seek review by the California Supreme Court, which has discretion over which cases it will review. On November 24, 2004 Genentech filed its petition for review by the California Supreme Court and on February 2, 2005 the California Supreme Court granted this petition. The appeal to the California Supreme Court was heard on February 5, 2008 and on April 24, 2008 overturned the award of \$200 million in punitive damages to the City of Hope, but upheld the award of \$300 million in compensatory damages. On May 9, 2008 Genentech paid \$476 million to the City of Hope, reflecting the amount of compensatory damages awarded, plus interest thereon from the date of the original decision on June 10, 2002.

During the appeals process interest had accrued on the total amount of the damages at a simple annual rate of 10%. During 2008 interest of \$11 million (2007: \$50 million) was recorded as the time cost of provisions within financing costs.

A full provision, totaling \$776 million as at December 31, 2007, had been recorded for these awards. As a result of the April 24, 2008 California Supreme Court decision, provisions totaling \$310 million were released to income as a favorable litigation settlement, of which \$200 million relates to the original award recorded in 2002 as an exceptional major legal case expense and \$110 million relates to interest accrued as a charge to financing costs in the intervening periods.

On October 3, 2002 Genentech entered into an arrangement with third-party insurance companies to post a surety bond in connection with this judgment. As part of this arrangement Genentech had pledged \$788 million in cash and investments to secure this bond. This amount was recorded as restricted cash within other current assets in the Annual Financial Statements 2007. During the third quarter of 2008 the court completed certain administrative procedures to dismiss the case. As a result the restrictions were lifted from the restricted cash and investments and the funds became available for use in Genentech's operations.

Genentech and City of Hope are in discussions but have not yet reached agreement regarding additional royalties and other amounts that Genentech owes to City of Hope under the 1976 agreement for third-party product sales and settlement of a third-party patent litigation that occurred after the 2002 judgment. Additional accruals have been made representing management's best estimate of the final obligation.

On October 4, 2004 Genentech received a subpoena from the United States Department of Justice, requesting documents related to the promotion of Rituxan. Genentech is co-operating with the associated investigation. Through counsel Genentech are having discussions with government representatives about the status of their investigation and Genentech's views on this matter, including potential resolution. Previously the investigation had been both civil and criminal in nature. Genentech was informed in August 2008 by the criminal prosecutor who handled this matter that the government has declined to prosecute Genentech criminally in connection with this investigation. The civil matter is still ongoing. The outcome of this matter cannot be determined at this time.

On April 11, 2003 MedImmune, Inc. ('MedImmune') filed a lawsuit against Genentech, the City of Hope National Medical Center, and Celltech R&D Ltd. in the U.S. District Court for the Central District of California, Los Angeles. The lawsuit relates to U.S. Patent No. 6,331,415 ('the Cabilly patent') that is co-owned by Genentech and the City of Hope National Medical Center and under which MedImmune and other companies have been licensed and are paying royalties to Genentech. The lawsuit included claims for violation of antitrust, patent and unfair competition laws. On June 11, 2008 Genentech announced that it had settled its patent litigation with MedImmune. Under the terms of the settlement agreement the litigation which was pending before the U.S. District Court for the Central District of California has now been fully resolved and dismissed.

On May 13, 2005 a request was filed by a third party for reexamination of the Cabilly patent. On July 7, 2005 the U.S. Patent and Trademark Office ordered a reexamination of this patent. On September 13, 2005 the Patent Office issued an initial non-final Office action rejecting the claims of the patent. Genentech filed a response on November 25, 2005. A second reexamination request for this same patent was filed on December 23, 2005 by another third party and on

January 23, 2006 the Patent Office granted that reexamination request. On June 6, 2006 the two reexaminations were combined by the Patent Office into a single reexamination. On August 16, 2006 the Patent Office issued a non-final Office action in the merged proceeding, rejecting the claims of the Cabilly patent based on the issues raised in the two reexamination requests. Genentech filed its response on October 30, 2006. On February 16, 2007 the Patent Office mailed a final Office action rejecting all 36 claims of the Cabilly patent. On May 21, 2007 Genentech responded to the final Office action and petitioned for continued reexamination. On May 31, 2007 the Patent Office granted Genentech's petition, withdrew the finality of the February 2007 Office action and agreed to treat Genentech's May 21, 2007 filing as a response to a first Office action. On February 25, 2008 the Patent Office mailed a final Patent Office action rejecting all the claims of the Cabilly patent. Genentech filed a response to that final Patent Office action on June 6, 2008. On July 19, 2008 the Patent Office mailed an advisory action replying to Genentech's response and confirming the rejection of all claims of the Cabilly patent. Genentech filed a notice of appeal challenging the rejection on August 22, 2008. Genentech's opening appeal brief was on December 9, 2008. The Cabilly patent, which expires in 2018, relates to methods used by Genentech and others to make certain antibodies or antibody fragments, as well as cells and DNA used in these methods. Genentech has licensed the Cabilly patent to other companies and derives significant royalties from these licenses. The claims of the Cabilly patent remain valid and enforceable throughout the reexamination and appeals processes. No provisions have been recorded in respect of this litigation as the outcome of this matter cannot be determined at this time. During the fourth quarter of 2008 the process of recognizing revenue from the Cabilly patents was changed from an estimated accruals basis to a cash basis. As a result of this change, net royalties decreased by approximately \$66 million, in the fourth quarter of 2008 compared to the third quarter. The Cabilly patent licenses contributed operating profit of \$156 million in 2008 (2007: \$133 million).

On May 30, 2008 Centocor, Inc. filed a patent lawsuit against Genentech and City of Hope in the U.S. District Court for the Central District of California. The lawsuit relates to the Cabilly patent and seeks a declaratory judgment of patent invalidity and unenforceability with regard to the Cabilly patent and of patent non-infringement with regard to certain of Centocor's products. Centocor filed an amended complaint on September 3, 2008. Genentech answered the complaint on September 19, 2008 and also filed counterclaims against Centocor alleging that four Centocor products infringe certain Genentech patents. Genentech filed an amendment to those counterclaims on October 10, 2008 and Centocor answered these counterclaims on November 26, 2008. A status conference has been set in the case for February 9, 2009. The outcome of this matter cannot be determined at this time.

In 2006 Genentech made development decisions involving its humanized anti-CD20 program, and its collaborator, Biogen Idec Inc., disagreed with certain of Genentech's development decisions related to humanized anti-CD20 products. Under Genentech's 2003 collaboration agreement with Biogen Idec, Genentech believe that it is permitted to proceed with further trials of certain humanized anti-CD20 antibodies, but Biogen Idec disagreed with Genentech's position. The disputed issues have been submitted to arbitration. In the arbitration, Biogen Idec filed motions for a preliminary injunction and summary judgment seeking to stop Genentech from proceeding with certain development activities, including planned clinical trials. On April 20, 2007 the arbitration panel denied Biogen Idec's motion for a preliminary injunction and Biogen Idec's motion for summary judgment. Resolution of the arbitration could require that both parties agree to certain development decisions before moving forward with humanized anti-CD20 antibody clinical trials (and possibly clinical trials of other collaboration products, including Rituxan), in which case Genentech may have to alter or cancel planned clinical trials in order to obtain Biogen Idec's approval. Each party is also seeking monetary damages from the other. The arbitrators held hearings on this matter over several days in September 2008 and closing arguments on December 9, 2008. The hearings formally closed on January 8, 2009. A final decision from the arbitrators is expected by no later than July 2009. The outcome of this matter cannot be determined at this time.

On June 28, 2003 Mr Ubaldo Bao Martinez filed a lawsuit against Porriño Town Council and Genentech España S.L. in the Contentious Administrative Court Number One of Pontevedra, Spain. The lawsuit challenges the Town Council's decision to grant licenses to Genentech España S.L. for the construction and operation of a warehouse and biopharmaceutical manufacturing facility in Porriño, Spain. On January 21, 2008 the Administrative Court ruled in favor of Mr Bao on one of the claims in the lawsuit and ordered the closing and demolition of the facility, subject to certain further legal proceedings. On February 12, 2008, Genentech and the Town Council filed appeals of the Administrative Court decision at the High Court in Galicia, Spain. In addition, Genentech are evaluating with legal counsel in Spain whether there may be other administrative remedies available to overcome the Administrative Court's ruling. Genentech sold the assets of Genentech España S.L., including the Porriño facility, to Lonza Group Ltd. ('Lonza') in December 2006, and Lonza has operated the facility since that time. Under the terms of that sale, Genentech retained control of the defense of this lawsuit and agreed to indemnify Lonza against certain contractually defined liabilities up to a specified limit, which is currently estimated to be approximately \$100 million. No provisions have been recorded in respect of this

litigation as the outcome of this matter and Genentech's indemnification obligation to Lonza, if any, cannot be determined at this time.

On May 8, June 11, August 8, and September 29, of 2008, Genentech was named as a defendant, along with InterMune, Inc. and its former chief executive officer, W. Scott Harkonen, in four separate class-action complaints filed in the U.S. District Court for the Northern District of California on behalf of plaintiffs who allegedly paid part or all of the purchase price for a product that was licensed by Genentech to Connecticut Corporation and was subsequently assigned to InterMune. The complaints are related in part to royalties that Genentech received. The May 8, June 11 and August 8 complaints have been consolidated into a single amended complaint that claims and seeks damages for violations of federal racketeering laws, unfair competition laws, and consumer protection laws, and for unjust enrichment. This matter was formally related to the consolidated complaint on December 10, 2008. Genentech's motion to dismiss these matters is currently scheduled for hearing on February 2, 2009. The September 29 complaint includes six claims, but only names Genentech as a defendant in one claim for damages for unjust enrichment. The outcome of these matters cannot be determined at this time.

Subsequent to the Roche Proposal, more than thirty shareholder lawsuits have been filed against Genentech and/or the members of its Board of Directors, and various Roche entities including Roche Holdings Inc. and Roche Holding Ltd. (Roche Holding AG). The lawsuits are currently pending in various state courts, including the Delaware Court of Chancery and San Mateo County Superior Court, as well as in the United States District Court for the Northern District of California. The lawsuits generally assert class-action claims for breach of fiduciary duty and aiding and abetting breaches of fiduciary duty based in part on allegations that, in connection with Roche's offer to purchase the remaining shares, some or all of the defendants have failed to properly value Genentech, have failed to solicit other potential acquirers and are engaged in improper self-dealing. Several of the suits also seek the invalidation, in whole or in part, of the July 1999 Affiliation Agreement between Genentech and RHI (Affiliation Agreement), and an order deeming Articles 8 and 9 of Genentech's Amended and Restated Certificate of Incorporation inapplicable or invalid to a potential transaction with Roche. The outcome of these matters cannot be determined at this time.

On October 27, 2008 Genentech and Biogen Idec Inc. filed a complaint against Sanofi-Aventis Deutschland GmbH ('Sanofi'), Sanofi-Aventis US LLC and Sanofi-Aventis US Inc. in the Northern District of California seeking a declaratory judgment that certain Genentech products, including Rituxan, do not infringe Sanofi's U.S. Patents 5,849,522 ('the '522 patent') and 6,218,140 ('the '140 patent') and a declaratory judgment that the 522 and 140 patents are invalid. On December 2, 2008 Sanofi filed a motion to dismiss this complaint for lack of jurisdiction. A discovery hearing relating to this motion is currently set for February 13, 2009. Also on October 27, 2008 Sanofi filed suit with Genentech and Biogen Idec in the Eastern District of Texas, Lufkin Division, claiming that Rituxan and at least eight other Genentech products infringe the 522 and 140 patents. On January 22, 2009 Genentech filed a motion to transfer this matter to the Northern District of California. Sanofi is seeking preliminary and permanent injunctions, compensatory and exemplary damages, and other relief. In addition on October 24, 2008. Hoechst GmbH filed with the ICC International Court of Arbitration (Paris) a request for arbitration against Genentech, relating to a terminated agreement between Hoechst's predecessors and Genentech that pertained to the above patents and related patents outside the United States. Genentech's answer to the arbitration request was filed on January 19, 2009. Hoechst is seeking payments on royalties on sales of Genentech products, damages for breach of contract, and other relief. Genentech intends to vigorously defend itself. The outcome of these matters cannot be determined at this time.

Genentech's annual report and quarterly SEC filings contain the detailed disclosures of litigation matters that are required by U.S. GAAP. These include further details on the above matters as well as including information on other litigation that is not currently as significant as the matters referred to above.

25. Other non-current liabilities

Other non-current liabilities *in millions of USD*

	2008	2007
Deferred income	100	280
Other long-term liabilities	51	166
Total other non-current liabilities	151	446

26. Debt

Debt: recognized liabilities *in millions of USD*

	2008	2007
Debt instruments	3,012	3,109
Amounts due to related parties	7,817	4,664
Amounts due to banks and other financial institutions	-	4
Genentech leasing obligations ³	319	270
Other borrowings	80	98
Total debt	11,228	8,145
Reported as		
- Long-term debt	10,030	6,337
- Short-term debt	1,198	1,808
Total debt	11,228	8,145

Debt: repayment terms *in millions of USD*

	2008	2007
Within one year	1,198	1,808
Between one and two years	1,322	504
Between two and three years	2,300	1,355
Between three and four years	610	1,518
Between four and five years	-	610
More than five years	5,798	2,350
Total debt	11,228	8,145

The fair value of the debt instruments is \$3 billion (2007: \$3.1 billion) and the fair value of total debt is \$11.2 billion (2007: \$8.1 billion). This is calculated based on the observable market prices of the debt instruments or the present value of the future cash flows on the instrument, discounted at a market rate of interest for instruments with similar credit status, cash flows and maturity periods.

There are no pledges on RHI's assets in connection with debt.

Debt instruments

Recognized liabilities and effective interest rates of debt instruments *in millions of USD*

	Effective interest rate	2008	2007
U.S. dollar bonds			
'Chameleon' 6.75% due July 6, 2009, principal \$487 million	6.77%	493	504
Genentech Senior Notes			
4.40% Senior Notes due July 15, 2010, principal \$500 million	4.53%	519	505
4.75% Senior Notes due July 15, 2015, principal \$1 billion	4.87%	1,000	1,000
5.25% Senior Notes due July 15, 2035, principal \$500 million	5.39%	500	500
Genentech commercial paper			
Notes due at various dates until January 23, 2009, principal \$500 million (2007: principal \$600 million due until January 22, 2008)	0.80% (2007:4.46%)	500	600
Total debt instruments		3,012	3,109

Fair Value Option

In 2005 the RHI Group applied the Fair Value Option on one of its outstanding debt instruments on which RHI had been applying fair value hedge accounting in the past. This debt instrument is the 'Chameleon' U.S. dollar bonds. The Fair Value Option treatment is based on the elimination of an accounting mismatch which had been recognized between

the hedging swaps (reported at fair value) and the hedged bonds (reported at amortized cost). The difference between the carrying value and the principal amount for these debt instruments was \$6 million (2007: \$16 million).

Issuance of new debt instruments – 2007

Genentech commercial paper program: In October 2007 Genentech established a commercial paper program under which it can issue up to \$1 billion of unsecured commercial paper notes. Maturities under the program generally vary from overnight to five weeks and cannot exceed 397 days. As at December 31, 2008 unsecured commercial paper notes with a principal amount of \$500 million (2007: \$600 million) and an average interest rate of 0.80% (2007: 4.46%) were outstanding. Genentech intends to use the proceeds for general corporate purposes.

Repayments, redemptions and conversions of debt instruments - 2007

Conversion and redemption of 'LYONs V' U.S. dollar exchangeable notes: On June 22, 2007 the RHI Group announced that it would exercise its option to call these notes for redemption on July 25, 2007 at the original issue amount plus accrued original issue discount ('OID'). In the period to July 24, 2007 notes with a principal amount of \$848 million were converted into 4.5 million non-voting equity securities of Roche Holding Ltd. and the remaining notes were redeemed for cash on July 25, 2007. A net gain of \$10 million was recorded within gains (losses) on equity derivatives in financial income, which consisted of \$518 million for the carrying value of the converted and redeemed bonds and \$332 million for the carrying value of the embedded derivative liability, less \$840 million of cash used to purchase the non-voting equity securities used in the conversions or to redeem the remaining outstanding bonds at the call date.

Redemption of European Medium Term Note program U.S. dollar bonds: On the due date of October 2, 2007 the RHI Group redeemed these bonds with a principal value of \$750 million at the original issue amount plus accrued original issue discount ('OID'). The cash outflow was \$750 million. There was no gain or loss recorded in the income statement upon the redemption.

Cash outflows from repayments, redemptions and conversions of debt instruments *in millions of USD*

	2008	2007
'LYONs V' U.S. dollar exchangeable notes	-	(840)
European Medium Term Note program U.S. dollar bonds	-	(750)
Genentech commercial paper (net repayment)	(99)	-
Total cash outflows from repayments and redemptions during the year	(99)	(1,590)

Recognized liabilities due to related parties

The movements of the amounts due to related parties are shown in the table below:

Recognized liabilities due to related parties *in millions of USD*

	2008	2007
At January 1	4,664	2,300
Cash inflows from related parties	4,427	2,464
Cash outflows to related parties	(1,274)	(100)
At December 31	7,817	4,664

Recognized liabilities and effective interest rates of amounts due to related parties *in millions of USD*

	Effective interest rate	2008	2007
Term note 5.00% due January 4, 2008, principal \$18 million	5.00%	-	18
Term note 5.00% due January 4, 2008, principal \$3 million	5.00%	-	3
Term note 5.30% due January 4, 2008, principal \$13 million	5.30%	-	13
Term note 5.05% due February 7, 2008, principal \$100 million	5.05%	-	100
Term note 6.25% due March 25, 2008, principal \$250 million	6.35%	-	250
Term note 5.05% due June 6, 2008, principal \$20 million	5.11%	-	20
Term note 3.79% due September 18, 2008, principal \$800 million	3.83%	-	800
Term note 5.95% due June 7, 2010, principal \$350 million	6.04%	280	350
Term note 5.95% due October 15, 2010, principal \$500 million	6.04%	500	500
Term note 6.15% due December 16, 2011, principal \$1.5 billion	6.24%	1500	1,500
Term note 6.20% due September 17, 2012, principal \$250 million	6.35%	250	250
Term note 6.20% due September 17, 2012, principal \$360 million	6.30%	360	360
Term note 6.45% due July 17, 2014, principal \$500 million	6.55%	500	500
Term note 5.80% due February 12, 2018, principal \$ 1.4 billion	5.88%	1,400	-

Term note 5.80% due February 12, 2018, principal \$ 2,0 billion	5.88%	2,000	-
Term note 4.50% due September 19, 2011, principal \$ 800 million	4.55%	800	-
Term note 1.75% due January 19, 2009, principal \$ 150 million	1.75%	150	-
Term note 2.10% due May 5, 2009, principal \$ 55 million	2.11%	55	-
Term note 2.25% due March 15, 2010, principal \$ 22 million	2.26%	22	-
Total amounts due to related parties		7,817	4,664

Issues from related parties: Issues of new term notes from related parties are shown in the table below:

Cash inflows from related parties *in millions of USD*

	2008	2007
Term note 5.95% issued January 16, 2007	-	500
Term note 5.95% issued June 6, 2007	-	350
Term note 6.20% issued June 6, 2007	-	100
Term note 6.45% issued July 17, 2007	-	500
Term note 6.20% issued September 17, 2007	-	360
Term note 6.20% issued September 17, 2007	-	250
Term note 6.25% issued September 25, 2007	-	250
Term note 5.30% issued November 26, 2007	-	13
Term note 5.00% issued December 4, 2007	-	18
Term note 5.05% issued December 6, 2007	-	20
Term note 5.05% issued December 7, 2007	-	100
Term note 5.00% issued December 27, 2007	-	3
Term note 5.80% issued February 12, 2008	1,400	-
Term note 5.80% issued June 30, 2008	2,000	-
Term note 2.25% issued March 13, 2008	22	-
Term note 4.50% issued September 18, 2008	800	-
Term note 1.75% issued December 17, 2008	150	-
Term note 2.10% issued May 5, 2008	55	-
Total cash inflows from related party issues	4,427	2,464

Payments to related parties: Payments of term notes to related parties are shown in the table below:

Cash outflows to related party issues *in millions of USD*

	2008	2007
Term note 6.20% due December 6, 2007, principal \$100 million	-	100
Term note 5.00% due January 4, 2008, principal \$3 million	3	-
Term note 5.00% due January 4, 2008, principal \$18 million	18	-
Term note 5.30% due January 4, 2008, principal \$13 million	13	-
Term note 5.05% due February 7, 2008, principal \$100 million	100	-
Term note 6.25% due March 25, 2008, principal \$250 million	250	-
Term note 5.95% due June 7, 2010, principal \$350 million	70	-
Term note 5.05% due June 6, 2008, principal \$20 million	20	-
Term note 3.79% due September 18, 2008, principal \$800 million	800	-
Total cash outflows to related party issues	1,274	100

27. Equity attributable to RHI shareholder

Changes in equity attributable to RHI shareholder *in millions of USD*

	Share capital	Retained earnings	Fair value reserve	Hedging reserve	Total
Year ended December 31, 2007					
At January 1, 2007	1	4,568	128	14	4,711
Available-for-sale investments					
- Valuation gains (losses) taken to equity	-	-	(18)	-	(18)
- Transferred to income statement on sale or impairment	-	-	16	-	16
Cash flow hedges					
- Gains (losses) taken to equity	-	-	-	(38)	(38)
- Transferred to income statement ^{a)}	-	-	-	(2)	(2)
- Transferred to the initial balance sheet carrying value of hedged items	-	-	-	-	-
Defined benefit plans					
- Actuarial gains (losses) ⁹	-	142	-	-	142
Income taxes on items taken directly to or transferred from equity	-	(64)	(3)	16	(51)
Non-controlling interests	-	1	(7)	9	3
Net income recognized directly in equity	-	79	(12)	(15)	52
Net income recognized in income statement	-	2,070	-	-	2,070
Total recognized income and expense	-	2,149	(12)	(15)	2,122
Dividends paid	-	-	-	-	-
Equity compensation plans	-	470	-	-	470
Genentech share repurchases ³	-	(749)	-	-	(749)
Changes in non-controlling interests	-	35	-	-	35
At December 31, 2007	1	6,473	116	(1)	6,589

a) Of amounts transferred to income statement losses of \$8 million were reported as 'Royalties and other operating income' and gains of \$6 million as 'Financial income'.

	Share capital	Retained earnings	Fair value reserve	Hedging reserve	Total
Year ended December 31, 2008					
At January 1, 2008	1	6,473	116	(1)	6,589
Available-for-sale investments					
- Valuation gains (losses) taken to equity	-	-	(178)	-	(178)
- Transferred to income statement on sale or impairment	-	-	19	-	19
Cash flow hedges					
- Gains (losses) taken to equity	-	-	-	(52)	(52)
- Transferred to income statement ^{a)}	-	-	-	77	77
- Transferred to the initial balance sheet carrying value of hedged items	-	-	-	-	-
Defined benefit plans					
- Actuarial gains (losses) ⁹	-	(956)	-	-	(956)
Income taxes on items taken directly to or transferred from equity		345	69	(10)	404
Non-controlling interests	-	-	39	(7)	32
Net income recognized directly in equity	-	(611)	(51)	8	(654)
Net income recognized in income statement	-	1,870	-	-	1,870
Total recognized income and expense	-	1,259	(51)	8	1,216
Dividends paid	-	-	-	-	-
Equity compensation plans	-	751	-	-	751
Genentech share repurchases ³	-	(436)	-	-	(436)
Changes in ownership interests in subsidiaries					
- Ventana ⁶	-	(879)	-	-	(879)
Changes in non-controlling interests	-	(41)	-	-	(41)
At December 31, 2008	1	7,127	65	7	7,200

a) Of amounts transferred to income statement losses of \$80 million (2007: losses of \$8 million) were reported as 'Royalties and other operating income' and gains of \$3 million (2007: gains of \$6 million) as 'Financial income'.

Share capital

As of December 31, 2008 the authorized and issued share capital of Roche Holdings, Inc., which is the RHI Group's parent company, consisted of 1,000 shares with a nominal value of \$1,000 each, as in the preceding year. All the shares are indirectly owned by Roche Holding Ltd, a public company registered in Switzerland.

Own equity instruments

RHI holds none of its own equity shares.

Reserves

Fair value reserve: The fair value reserve represents the cumulative net change in the fair value of available-for-sale financial assets until the asset is sold, impaired or otherwise disposed.

Hedging reserve: The hedging reserve represents the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

28. Non-controlling interests

Changes in equity attributable to non-controlling interests *in millions of USD*

	2008	2007
At January 1	5,265	4,316
Net income recognized directly in equity	(32)	(3)
Net income recognized in income statement		
- Genentech ³	1,532	1,209
Total recognized income and expense	1,500	1,206
Ventana acquisition ⁶	291	-
Equity compensation plans	529	373
Genentech share repurchases ³	(344)	(595)
Changes in ownership interests in subsidiaries		
- Ventana ⁶	(291)	-
Changes in non-controlling interests	41	(35)
At December 31	6,991	5,265
Of which		
- Genentech ³	6,991	5,265
Total non-controlling interests	6,991	5,265

29. Cash flow statement

Cash flows from operating activities

Cash flows from operating activities arise from the RHI Group's primary activities in the Pharmaceuticals and Diagnostics businesses. These are calculated by the indirect method by adjusting RHI's operating profit for any operating income and expenses that are not cash flows (for example depreciation, amortization and impairment) in order to derive the cash generated from operations. This and other operating cash flows are shown in the cash flow statement. Operating cash flows also include income taxes paid on all activities.

Cash generated from operations *in millions of USD*

	2008	2007
Net income	3,402	3,279
Add back non-operating (income) expense		
- Financial income ⁴	(422)	(566)
- Financing costs ⁴	341	387
- Financing costs – related parties ³¹	411	171
- Income taxes ⁵	2,153	2,097
- Major legal cases ²⁴	(250)	-
- Changes in RHI Group organization ⁷	225	-
Operating profit before exceptional items	5,860	5,368
Depreciation of property, plant and equipment ¹¹	564	479
Amortization of intangible assets ¹³	305	278
Impairment of intangible assets ¹³	39	39
Impairment of property, plant and equipment ¹¹	17	1
Operating expenses for defined benefit post-employment plans ⁹	85	102
Operating expenses for equity-settled equity compensation plans ¹⁰	404	439
Other adjustments	171	266
Cash generated from operations	7,445	6,972

Cash flows from investing activities

Cash flows from investing activities are principally those arising from the RHI Group's investments in property, plant and equipment and intangible assets, and from the acquisition of subsidiaries. Cash flows connected with the RHI Group's portfolio of marketable securities and other investments are also included, as are any interest and dividend payments received in respect of these securities and investments. These cash flows indicate the RHI Group's net reinvestment in

its operating assets and the cash flow effects of business combinations and divestments, as well as the cash generated by the RHI Group's other investments.

Cash flows from financing activities

Cash flows from financing activities are primarily the proceeds from the issue and repayment of the RHI Group's equity and debt instruments. They also include interest payments and dividend payments on these instruments. Cash flows from short-term financing, including finance leases, are also included. These cash flows indicate the RHI Group's transactions with the providers of its equity and debt financing. Cash flows from short-term borrowings are shown as a net movement, as these consist of a large number of transactions with short maturity.

Significant non-cash transactions

An increase in property, plant and equipment of \$106 million (2007: \$199 million) was recorded from Genentech leasing arrangements (see Note 3) and there was a corresponding increase in long-term debt.

30. Risk management

RHI Group risk management

Risk management is a fundamental element of the Roche Group business practice on all levels and encompasses different types of risks. At a Roche Group level risk management is an integral part of the business planning and controlling processes. Material risks are monitored and regularly discussed with the Corporate Executive Committee and the Audit Committee of the Board of Directors.

Financial risk management

The RHI Group is exposed to various financial risks arising from its underlying operations and corporate finance activities. The RHI Group's financial risk exposures are predominantly related to changes in interest rates, equity prices and to an extent, foreign exchange rates, as well as the creditworthiness and the solvency of RHI's counterparties.

RHI's subsidiary Genentech has its own treasury operation. Genentech has operational independence, whilst working within a financial risk management framework that is consistent with the rest of the RHI Group. More information on their financial risks is available in the annual report of Genentech.

Financial risk management within the Roche Group is governed by policies reviewed by the boards of directors of Roche or Genentech as appropriate to their areas of statutory responsibility. These policies cover credit risk, liquidity risk and market risk. The policies provide guidance on risk limits, type of authorized financial instruments and monitoring procedures. As a general principle, the policies prohibit the use of derivative financial instruments for speculative trading purposes. Policy implementation and day-to-day risk management are carried out by the relevant treasury functions; and regular reporting on these risks is performed by the relevant accounting and controlling functions within the Roche Group and Genentech.

Carrying value and fair value of financial assets in millions of USD

By line Items in notes	Available -for-sale	FVtPL ^{a)} - desig- nated	FVtPL ^{a)} - held for trading	Held to maturity	Carrying value by asset class		
					Loans and re- ceivables	Total	Fair value
Year ended							
December 31, 2008							
Accounts receivable – third and related parties	-	-	-	-	3,815	3,815	3,815
Accrued interest income	-	-	-	-	1	1	1
Marketable securities:							
-Money market instruments and time accounts over 3 months	1,646	-	-	-	-	1,646	1,646
-Bonds and debentures	3,732	-	971	-	-	4,703	4,703
-Shares	33	-	-	-	-	33	33
-Other investments	-	-	-	-	-	-	-
Cash and cash equivalents	-	-	-	-	2,910	2,910	2,910
Derivative financial instruments	-	-	79	-	-	79	79
Available-for-sale investments	331	-	-	-	-	331	331
Held-to-maturity investments	-	-	-	15	-	15	15
Loans receivable – third and related parties	-	-	-	-	98	98	98
Long-term trade receivables	-	-	-	-	1	1	1
Other financial current assets	-	-	-	-	353	353	353
Restricted cash	-	-	-	-	-	-	-
Other long-term assets	-	-	-	-	21	21	21
Total	5,742	-	1,050	15	7,199	14,006	14,006

By line Items in notes	Available -for-sale	FVtPL ^{a)} - desig- nated	FVtPL ^{a)} - held for trading	Held to maturity	Carrying value by asset class		
					Loans and re- ceivables	Total	Fair value
Year ended							
December 31, 2007							
Accounts receivable – third and related parties	-	-	-	-	3,949	3,949	3,949
Accrued interest income	-	-	-	-	1	1	1
Marketable securities:							
-Money market instruments and time accounts over 3 months	1,492	-	-	-	-	1,492	1,492
-Bonds and debentures	1,993	-	1,002	-	-	2,995	2,995
-Shares	150	-	-	-	-	150	150
-Other investments	-	-	-	-	-	-	-
Cash and cash equivalents	-	-	-	-	1,042	1,042	1,042
Derivative financial instruments	-	-	33	-	-	33	33
Available-for-sale investments	458	-	-	-	-	458	458
Held-to-maturity investments	-	-	-	17	-	17	17
Loans receivable – third and related parties	-	-	-	-	95	95	95
Long-term trade receivables	-	-	-	-	67	67	67
Other financial current assets	-	-	-	-	339	339	339
Restricted cash	-	-	-	-	788	788	788
Other long-term assets	-	-	-	-	22	22	22
Total	4,093	-	1,035	17	6,303	11,448	11,448

a) Fair-value-through-profit-or-loss

Credit risk

Credit risk arises from the possibility that counterparties to transactions may default on their obligations, causing financial losses for the RHI Group. The objective of managing counterparty credit risk is to prevent losses of liquid funds deposited with or invested in such counterparties.

The maximum exposure to credit risk resulting from financial activities, without considering netting agreements and without taking account of any collateral held or other credit enhancements, is equal to the carrying value of RHI's financial assets.

Trade receivables: These are subject to a policy of active credit risk management which focuses on the assessment of credit availability, ongoing credit evaluation and account monitoring procedures. The objective of the management of trade receivables from third parties is to sustain the growth and profitability of the RHI Group by optimizing asset utilization whilst maintaining risks at an acceptable level. Except as noted below, there is no significant concentration of counterparty credit risk due to the RHI Group's large number of customers. Risk limits and exposures are continuously monitored. Additionally, the RHI Group obtains credit insurance and similar enhancements when appropriate to protect the collection of trade receivables. No collateral was held for loans and receivables at the end of 2008 and 2007.

At December 31, 2008 the RHI Group's combined trade accounts receivable balance with three national wholesale distributors, AmerisourceBergen Corp., Cardinal Health Inc. and McKesson Corp., was \$1,355 million representing 71% of RHI's consolidated third party trade accounts receivables (2007: \$1,365 million representing 71%).

Nature and geographical location of trade receivables (not overdue) counterparties in millions of USD

	2008				2007			
	Total	Public	Whole-salers/dis-tributors	Private	Total	Public	Whole-salers/dis-tributors	Private
Switzerland	1	-	1	-	2	-	2	-
European Union	7	2	5	-	5	-	4	1
North America	1,774	81	1,497	196	1,905	213	1,499	193
Japan	46	-	46	-	-	-	-	-
Rest of Asia	1	1	-	-	-	-	-	-
Total	1,829	84	1,549	196	1,912	213	1,505	194

In addition to third party Trade Receivable, the RHI Group had \$2.0 billion accounts receivable balances with related parties mainly in the European Union and Switzerland (2007: \$1.9 billion).

Cash and marketable securities: These are subject to a policy of restricting exposures to high-quality counterparties and setting defined limits for individual counterparties. These limits and counterparty credit ratings are reviewed regularly. Investments in marketable securities are entered into on the basis of guidelines with regard to liquidity, quality and maximum amount. As a general rule, the RHI Group invests only in high quality securities with adequate liquidity. Cash and short-term deposits are subject to rules which limit RHI's exposure to individual financial institutions. RHI signs netting agreements under an ISDA (International Swaps and Derivatives Association) master agreement with the respective counterparties in order to control exposures on derivative positions.

Rating analysis of cash and fixed income marketable securities (market values)

	2008		2007	
	(mUSD)	(% of total)	(mUSD)	(% of total)
AAA-range	5,699	62	2,992	54
AA-range	1,148	12	675	12
A-range	2,122	23	1,413	26
BBB-range	280	3	384	7
Below BBB-range	10	0	65	1
Total	9,259	100	5,529	100

Overdue assets: Financial assets which are past due but not impaired total \$19 million (2007: \$73 million).

Aging analysis of overdue but not impaired financial assets by class in millions of USD

	Total amount overdue	0-1 month	1-3 months	4-6 months	6-12 months	more than 1 year
Year ended December 31, 2008						
Loans and receivables	19	9	5	3	2	-
Year ended December 31, 2007						
Loans and receivables	73	55	12	2	4	-

As at December 31, 2008 there were no financial assets whose terms have been renegotiated (2007: none).

Liquidity risk

Liquidity risk arises through a surplus of financial obligations over available financial assets due at any point in time. RHI's approach to liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time.

Roche and Genentech enjoy strong credit quality and are rated by at least one major credit rating agency. The ratings will permit efficient access to the international capital markets in the event of major financing requirements. In addition, the RHI Group has unused committed credit lines with various financial institutions totaling \$4.5 billion (2007: \$4.7 billion).

Contractual maturity analysis of financial liabilities in millions of USD

	Total	0-3 months	4-6 months	7-12 months	1-2 years	2-3 years	3-4 years	4-5 years	Over 5 years
Year ended									
December 31, 2008									
Total debt ^{a)}	10,804	897	154	197	1,641	2,699	837	189	4,190
Trade payables	385	383	1	-	1	-	-	-	-
Accruals	2,934	2,104	60	755	15	-	-	-	-
Derivative financial instruments	31	31	-	-	-	-	-	-	-
Other liabilities:									
current & non-current	252	111	30	51	55	1	1	1	2
Total financial liabilities	14,406	3,526	245	1,003	1,712	2,700	838	190	4,192
Year ended									
December 31, 2007									
Total debt ^{a)}	10,455	1,174	120	1,011	854	1,667	1,758	780	3,091
Trade payables	550	550	-	-	-	-	-	-	-
Accruals	2,556	1,888	162	491	15	-	-	-	-
Derivative financial instruments	19	19	-	-	-	-	-	-	-
Other liabilities:									
current & non-current	330	106	30	17	175	-	-	1	1
Total financial liabilities	13,910	3,737	312	1,519	1,044	1,667	1,758	781	3,092

a) Total debt in the above table shows undiscounted cash flows, whereas the carrying value in the consolidated balance sheet reflects discounted cash flows.

Market risk

Market risk arises from changing market prices of RHI's financial assets or financial liabilities. Market risk may affect RHI's financial result and the value of RHI's equity.

Roche uses Value-at-Risk (VaR) to measure the impact of market risk on its financial instruments. Roche has defined VaR limits to manage market risk. VaR data are reported on a monthly basis and indicate the value range within which a given financial instrument will fluctuate with a pre-set probability as a result of movements in market prices. VaR is a statistical measure which implicitly assumes that value changes of the recent past are indicative of value changes in the

future. VaR figures do not represent actual or expected losses, or possible worst-case losses over the stated period. Also, VaR does not consider any effects of favorable market movements.

VaR figures are calculated using a historical simulation approach. For each scenario, all financial instruments are fully valued and the total change in value and earnings is determined. All VaR calculations are based on a 95% confidence level and a holding period of 20 trading days over the past ten years. This holding period reflects the time required to change the corresponding risk exposure, should this be deemed appropriate. Longer holding periods increase the probability of higher value changes and lead to increased VaR figures.

Actual future gains and losses associated with our treasury activities may differ materially from the VaR analyses performed due to the inherent limitations associated with predicting the timing and amount of changes to interest rates, foreign currency exchanges rates and equity investment prices, particularly in periods of high market volatilities. Furthermore, the VaR numbers below do not include the effect of changes in credit spreads.

Market risk of financial instruments *in millions of USD*

	December 31, 2008	December 31, 2007
VaR - Foreign exchange component	68	45
VaR - Interest rate component	68	74
VaR - Other price component	31	45
Diversification	(45)	(46)
VaR - Total market risk	122	118

At December 31, 2008, the total VaR of the financial assets and liabilities was \$122 million (2007: \$118 million). The foreign exchange VaR increased and arises mainly from hedging of non-U.S. dollar cash flows from future royalty income over the next five years at Genentech. The lower contribution from the interest rate component was caused by the ageing of fixed-term liabilities. Other price risk arises mainly from movements in the prices of equity securities. The decrease of the other price component is due to significantly reduced equity security holdings. At December 31, 2008, the RHI Group held equity securities with a market value of \$0.4 billion (2007: \$0.6 billion). This includes holdings in biotechnology companies, which were acquired in the context of licensing transactions or scientific collaborations. Although the holdings in equity securities decreased, the resulting VaR for other price risk slightly increased due to a higher volatility of certain holdings.

Foreign exchange risk

The RHI Group is exposed to movements in foreign currencies affecting its financial result and the value of RHI's equity. Foreign exchange risk arises because the amount of local currency paid or received for transactions denominated in foreign currencies may vary due to changes in exchange rates (transaction exposures).

The objective of RHI's foreign exchange risk management activities is to preserve the economic value of its current and future assets and to minimize the volatility of RHI's financial result. The primary focus of RHI's foreign exchange risk management activities is on hedging transaction exposures arising through foreign currency flows or monetary positions held in foreign currencies. The RHI Group does not currently hedge translation exposures using financial instruments.

RHI monitors transaction exposures on a daily basis. The net foreign exchange result and the corresponding VaR parameters are reported on a monthly basis. RHI uses forward contracts, foreign exchange options and cross-currency swaps to hedge transaction exposures. Application of these instruments intends to continuously lock in favorable developments of foreign exchange rates, thereby reducing the exposure to potential future movements in such rates.

Interest rate risk

Interest rate risk arises from movements in interest rates which could affect RHI's financial result or the value of RHI's equity. Changes in interest rates may cause variations in interest income and expense. In addition, they may affect the market value of certain financial assets, liabilities and hedging instruments. The primary objective of RHI's interest rate management is to protect the net interest result.

Interest rate exposures and the corresponding VaR parameters are reported on a monthly basis. RHI uses forward contracts, options and swaps to hedge its interest rate exposures. Depending on the interest rate environment of the major currencies, RHI will use these instruments to generate the appropriate mix of fixed and floating rate exposures.

Other price risk

Other price risk arises mainly from movements in the prices of equity securities held by RHI and Genentech. In 2008, the RHI Group held equity securities with a market value of \$0.4 billion (2007: \$0.6 billion). This amount includes holdings in biotechnology companies, which were acquired in the context of licensing transactions or scientific collaborations. Due to the nature of their business, biotechnology companies are exposed to greater equity volatilities than general stock market fluctuations.

RHI manages the price risk through placing limits on individual and total equity investments. These limits are defined both as a percentage of total liquid funds and as an absolute number for individual equity investments.

Impairment of financial assets

During 2008 impairments of shares were triggered by a significant or prolonged price decline below cost value. Impairments of debt securities were recorded due to significant financial difficulties of the issuers.

Impairment losses by asset classes *in millions of USD*

	2008	2007
Loans and receivables	(3)	(1)
Available-for-sale financial assets		
- Shares	(67)	(21)
- Investments	(17)	-
- Debt securities	-	(30)
Total impairment losses	(87)	(52)

Capital

The RHI Group defines the capital that it manages as RHI's total equity, including non-controlling interests. RHI's objectives when managing capital are:

- To safeguard RHI's ability to continue as a going concern, so that it can continue to provide benefits for patients and returns to investors.
- To provide an adequate return to investors based on the level of risk undertaken.
- To have available the necessary financial resources to allow the RHI Group to invest in areas that may deliver future benefits for patients and returns to investors.
- To maintain sufficient financial resources to mitigate against risks and unforeseen events.

Capital is monitored on the basis of the equity ratio, which is calculated as being equity (including non-controlling interests) as a percentage of total assets. RHI's capital and equity ratio are shown in the table below.

Capital *in millions of USD*

	2008	2007
Capital and reserves attributable to RHI shareholder ²⁷	7,200	6,589
Equity attributable to non-controlling interests ²⁸	6,991	5,265
Total equity	14,191	11,854
Total assets	32,994	26,759
Equity ratio	43.0%	44.3%

The RHI Group is not subject to regulatory capital adequacy requirements as known in the financial services industry.

RHI has majority shareholdings in Genentech (see Note 3). Genentech is a public company and their objectives, policies and processes for managing their own capital are determined by local management.

31. Related parties

Controlling shareholders

Roche Finance Ltd (Roche Finanz AG), a Swiss corporation, owns all of the issued and outstanding shares of Roche Holdings, Inc. Roche Finance Ltd is a wholly owned, direct subsidiary of Roche Holding Ltd, a public company in Switzerland.

As a member of the Roche Group, all of the RHI Group's related party transactions are with Roche Group affiliates. The transactions include purchases of inventory and other materials, sales of inventory and other materials, allocation of research and development costs under cost-sharing agreements and collaborations, allocation of marketing and distribution costs under cost-sharing agreements, allocations of other expenses attributable to the U.S. business, and the payment and receipt of royalties.

Related party transactions *in millions of USD*

	Year ended December 31,	
	2008	2007
Sales	1,602	1,501
Royalty income	1,708	1,346
Contract revenue	76	40
Purchases of inventory and other materials	(823)	(817)
Reimbursements received under research and development cost sharing and collaboration agreements	584	430
Payments issued under research and development cost sharing and collaboration agreements	(92)	(64)
Profit-sharing expense	(89)	(187)
Other revenue (expense), net	(43)	21
Interest income	37	37
Interest expense	(421)	(204)

Related party balances *in millions of USD*

	December 31,	
	2008	2007
Accounts and loans receivable	2,085	2,059
Accounts and loans payable	(8,564)	(5,041)

Subsidiaries and associates

A listing of the major RHI Group subsidiaries is included in Note 33. Transactions between the parent company and its subsidiaries and between subsidiaries are eliminated on consolidation. The RHI Group has no associates.

Key management personnel

The purpose of Roche Holdings, Inc. is to act as a holding and financing company for the U.S. operations of the RHI Group and to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of Delaware. RHI has no operating functions except through its subsidiaries and the members of the RHI Group Board of Directors act as the chief operating decision-maker.

Board of Directors of Roche Holdings, Inc.

		Date of appointment
Dr Franz B. Humer	Chairman	May 15, 2001
Dr Erich Hunziker	Vice-Chairman	September 1, 2001
Dr Severin Schwan	Member of the Board	April 29, 2008
Frank J. D'Angelo	Member of the Board	December 2, 2008
Frederick C. Kentz III	Member of the Board	December 2, 2008
David P. McDede	Member of the Board	December 2, 2008
Bruce Resnick	Member of the Board	December 2, 2008

Dr Humer, Dr Hunziker and Dr Schwan did not receive remuneration or payment for their time and expenses related to their services from RHI during 2008 and 2007.

The members of the Board of Directors of Roche Holdings, Inc. who were appointed on December 2, 2008 receive remuneration, which consists of a salary, bonus and an expense allowance. The RHI Group pays social insurance contributions in respect of the above remuneration and pays contributions to pension and other post-employment benefit plans. They also participate in the equity compensation plans 'Roche Long-Term' and 'Roche Performance Share Plan'. The terms, vesting conditions and fair value of these awards are disclosed in Note 10. – Since December 2, 2008 the new members of the RHI Group Board of Directors have not received any awards relating to these two equity compensation plans.

Remuneration of members of the RHI Group Executive Committee ^{a)}

in thousands of USD

	2008 ^{a)}
Salaries, including bonuses and expenses	135
Social security costs	7
Pensions and other post-employment benefits	11
Equity compensation plans	105
Other employee benefits	10
Total	268

a) The numbers indicated in the table above include remuneration for the period from December 2, 2008 to December 31, 2008 for the members of the RHI Group Board of Directors appointed on December 2, 2008.

32. Subsequent events

On January 1, 2009 the shareholder of Roche Holdings, Inc. contributed the Roche Group's investment in IGEN International, Inc. to RHI as a capital contribution. As a result, RHI obtained a 100% controlling interest in IGEN International, Inc. and its subsidiary BioVeris Corporation effective January 1, 2009.

These two companies will both be reported as part of the Diagnostics operating segment. In 2008 their combined results showed revenues of approximately \$150 million, operating profit of approximately \$70 million and a net loss of approximately \$5 million. Their combined recognized net assets at December 31, 2008 were approximately \$0.4 billion, which included approximately \$1.9 billion of intangible assets and \$1.4 billion of related-party long-term debt.

There were no other significant events after the balance sheet date.

33. Subsidiaries and associates

Subsidiary and associates	Country of Incorporation	Equity interest %	
		2008	2007
Hoffmann-La Roche Inc.	United States	100%	100%
Roche Palo Alto LLC	United States	100%	100%
Genentech, Inc.	United States	55.8%	55.8%
HLR Consumer Health Inc.	United States	100%	100%
Roche Vitamins, Inc.	United States	100%	100%
Roche Diagnostics Corporation	United States	100%	100%
Roche Diagnostics Operations, Inc.	United States	100%	100%
Roche Finance USA, Inc.	United States	100%	100%
Roche Finance America, Inc.	United States	100%	100%
Roche Molecular Systems, Inc.	United States	100%	100%
Roche Carolina, Inc.	United States	100%	100%
Roche Colorado Corporation	United States	100%	100%
Disetronic Medical Systems Inc.	United States	100%	100%
Disetronic Sterile Products	United States	100%	-
454 Life Sciences Corporation	United States	100%	100%
Roche NimbleGen, Inc.	United States	100%	100%
Roche Madison, Inc.	United States	100%	-
Spring Bioscience Corp.	United States	100%	-
Therapeutics Human Polyclonals, Inc.	United States	100%	100%
Ventana Medical Systems, Inc.	United States	100%	-

Report of the RHI Group Auditors

Independent Auditor's Report to the Board of Directors of Roche Holdings, Inc., Wilmington, Delaware

We have audited the accompanying consolidated financial statements of Roche Holdings, Inc., which comprise the balance sheet as at December 31, 2008, and the income statement, cash flow statement, statement of recognized income and expense and statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes on pages 4 to 69.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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 these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require 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 Roche Holdings, Inc. as of December 31, 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



KPMG Klvnveld Peat Marwick Goerdeler SA

A handwritten signature in black ink, appearing to read 'J. A. Morris'.

John A. Morris

A handwritten signature in black ink, appearing to read 'F. Rouiller'.

François Rouiller

Basel, January 28, 2009