Roche Holdings, Inc.

Half-Year Report 2017

Roche Holdings, Inc. Interim Consolidated Financial Statements

Contents

Management Report

1. Review of the first six months ended June 30, 2017

Principal activities

Roche Holdings, Inc. (RHI) is the holding company for the Roche Group's U.S. operations and performs financing activities for other members of the RHI Group.

RHI Group results

During the first half of 2017 the RHI Group had sales of USD 12.6 billion, a growth of 7%, and an operating profit of USD 4.2 billion. The RHI Group had a positive cash flow from operating activities of USD 4.9 billion.

Sales in the Pharmaceuticals Division rose by 8% to USD 10.9 billion, mainly driven by growth from oncology and immunology products. The key growth drivers were the recently launched products Tecentriq and Ocrevus. Sales of Rituxan, Xolair, Activase/TNKase, Herceptin and Actemra also increased. Growth was negatively impacted by a decline in Tamiflu sales due to patent expiry in the US, and also by Tarceva.

Sales in the Diagnostics Division decreased by 1% to USD 1.7 billion. The decrease in Molecular Diagnostics and Diabetes Care sales was partially offset by growth in Tissue Diagnostics and Centralised and Point of Care Solutions.

The RHI Group's operating profit decreased by 13% to USD 4.2 billion mainly due to the intangible assets impairment charges in the first half of 2017. The RHI Group's operating profit margin decreased to 32.9% of sales. The RHI Group's net income decreased to USD 2.1 billion driven by the lower operating results.

Pharmaceuticals Division

Pharmaceuticals Division sales increased by 8% to USD 10.9 billion, driven by Tecentriq and Ocrevus which contributed USD 0.4 billion of new sales representing around half of the division's growth. In oncology, Herceptin and Perjeta continue to grow, with sales of USD 1.5 billion (+4%) and USD 0.5 billion (+10%) respectively. Avastin sales to third parties decreased by 3% to USD 1.5 billion due to competition from immunotherapy medicines in lung cancer. Rituxan sales grew to USD 2.2 billion (+6%) in both oncology and immunology. In addition, sales in immunology increased due to higher demand for Xolair and Actemra with combined sales of USD 1.2 billion (+17%). Sales growth was negatively impacted by a decline of Tamiflu (-29%) due to competition from generics following US patent expiry and Tarceva (-18%) due to competitive pressure. Mandatory discounts to hospitals under the 340B Drug Discount Program increased, although at a lower rate than in 2016. This was mainly due to higher sales of oncology products.

In oncology, the HER2 franchise benefited from increased demand for Herceptin and Perjeta. Herceptin sales were higher, partly as a result of the phasing of wholesaler purchases due the launch of a new formulation. Perjeta sales grew in the neoadjuvant and metastatic settings. The increase of Tecentriq sales was driven mainly by uptake in metastatic bladder cancer and in metastatic non-small cell lung cancer. In immunology, there was strong demand for Xolair with volume growth across both indications and Actemra driven by continued uptake of the subcutaneous (SC) formulation.

The introduction of a generic, biosimilar or non-comparable biologic version of the same or a similar medicine typically results in a significant reduction in net sales for the relevant product, as other manufacturers typically offer their versions at lower prices.

2017 interim product sales affected by recent patent expiry

	2017 (USD m)	2016 (USD m)	% change	Comment
Tamiflu	189	268	-29	US patent expiry in 2016
Valcyte/Cymevene	40	59	-33	US patent expiry in 2015

The intellectual property for biologics can involve multiple patents and patent timelines for each individual product and therefore it is more difficult to give an exact date for patent expiry for biologic medicines. The RHI Group currently estimates that some basic, primary patents for its major biologic medicines will begin to expire as follows:

- Rituxan: from around mid-2018.
- Herceptin: from around 2019.
- Avastin: from around 2020.
- Subcutaneous formulations of Rituxan and Herceptin: beyond 2025 (secondary patent rights).

There are still many uncertainties surrounding when specific biosimilar versions of the RHI Group's biologic medicines will be approved by the US Food and Drug Administration.

Royalties and other operating income remained stable at USD 2.0 billion. Royalty income has slightly increased compared to the first half of 2016, driven mainly by the related-parties royalties for Ocrevus, which was launched in the US in April 2017 and had a rapid uptake. This was partly offset by the lower income from out-licensing agreements mainly driven by lower related-party out-licensing income and also due to milestone payments in 2016 from the license agreements with Galenica for Mircera and Denali.

Cost of sales increased by 40% to USD 4.9 billion, mainly driven by the impairment charge related to Esbriet product intangibles acquired in the InterMune acquisition and by sales growth led by the uptake of Tecentriq and Ocrevus. As a percentage of sales, cost of sales increased by 10.4 percentage points to 45.1%.

Marketing and distribution costs remained stable at USD 1.2 billion. Costs were incurred to ensure increased patient access and for product launches, notably Tecentriq and Ocrevus.

Research and development costs increased by 15% to USD 2.6 billion as shown in the table below, due to increased spending on late stage development and higher impairment costs.

Pharmaceuticals Division – Research and development

Six months ended June 30,	2017 (USD m)	2016 (USD m)
Research and early development	(1,144)	(1,285)
Late stage development	(1,129)	(1,089)
Partnering, including Foundation Medicine	72	235
Restructuring plans	(1)	(1)
Amortisation of intangible assets	(38)	(39)
Impairment of intangible assets	(328)	(56)
Total	**(2,568)**	**(2,235)**
- of which related party	*(213)*	*(259)*

The oncology franchise remained the primary area of research and development with Tecentriq and the cancer immunotherapy portfolio being a key driver. This also applies to the late-stage development spending. In early-stage research and development, oncology represents the main area, with immunology also being a significant area of spending. In the first half of 2017, intangible asset impairment charges was USD 328 million compared to USD 56 million in the first half of 2016 and include impairments of USD 140 million due to the decision to stop development of one compound with an alliance partner following an assessment of clinical and non-clinical data and USD 111 million of a compound acquired as part of the Trophos acquisition arising from the launch of a competitor product.

General and administration costs decreased by 48% to USD 0.2 billion, mainly driven by the release of USD 203 million of legal provisions, based on the development of various litigations, notably the Accutane case.

The Pharmaceuticals Division's operating profit decreased by 15% to USD 4.0 billion, mainly driven by the impairment of intangible assets and higher research and development costs. This was partially offset by growth in the underlying operating performance and the release in legal provisions.

Diagnostics Division

Diagnostics Division sales decreased by 1% to USD 1.7 billion. This was mainly driven by the decrease in Diabetes Care sales to USD 0.2 billion (-10%), predominantly due to a continued spillover of Medicare prices to commercial plans for the blood glucose monitoring portfolio. The decrease in sales was partially offset by an increase in Tissue Diagnostics as a result of growth in companion diagnostics sales due to external partnerships with other pharmaceutical companies.

Additionally, Centralised and Point of Care Solutions sales increased by 3% to USD 0.7 billion primarily driven by the immunodiagnostics business.

Royalties and other operating income increased by 63% to USD 0.1 billion, mainly resulting from an out-licensing income from the settlement of a patent dispute.

Costs of sales remained stable at USD 1.0 billion, mainly due to an unfavourable product mix offset by a decrease in amortisation for intangible assets. Marketing and distribution costs were also stable at USD 0.4 billion, mainly due to slightly increased spending in Molecular Diagnostics, offset by cost containment in Diabetes Care. Research and development costs remained stable at USD 0.3 billion, mainly due to slightly higher spending in Molecular Diagnostics, offset by lower spending in Diabetes Care and higher reimbursement of research and development costs. General and administration costs decreased to USD 57 million, mainly due to an income from a settlement agreement for the Medical Devices Excise Tax.

Restructuring plans

The RHI Group continued with the implementation of several major restructuring plans initiated in prior years with a total cost of USD 61 million in the first half of 2017, compared to USD 58 million in the first half of 2016. Strategy plans in the Diagnostics Division that were launched in 2016 incurred costs of USD 37 million mainly for employee-related costs during the six months ended June 30, 2017. The strategic realignment of the Pharmaceuticals Division's manufacturing network incurred costs of USD 13 million mainly related to other site closure costs and other reorganization expenses. The divestment of Roche Carolina Inc., the subsidiary at the Florence site, has been completed with a loss on divestment of USD 3 million, which is included in this USD 13 million of costs.

Impairment of goodwill and intangible assets

There were impairment charges of USD 1,311 million in the Pharmaceuticals Division. The largest item was a charge of USD 983 million for the partial impairment of the Esbriet product intangible acquired as part of the InterMune acquisition. The main factor leading to this was lower-than-expected sales of Esbriet in the first half of 2017 relative to the most recent long-term forecasts. The next long-term forecasts will be prepared in the second half of 2017 and, depending upon any revised estimates for Esbriet in those forecasts, the intangible asset may require further testing for impairment or reversal of impairment in the 2017 RHI Annual Financial Statements. Other impairments in the Pharmaceuticals Division totalled USD 328 million. There were no impairments in the Diagnostics Division. Further details are given in Note 8 to the RHI Interim Financial Statements.

Legal and environmental cases

Based on the development of the various litigations, notably the Accutane case, some of the provisions previously held were released, resulting in income of USD 203 million for the six months ended June 30, 2017. Further details are given in Note 9 to the RHI Interim Financial Statements.

Treasury and taxation results

The RHI Group financed the Genentech transaction in 2009 by a combination of own funds, bonds, notes and commercial paper raising net proceeds of USD 40.3 billion through a series of debt offerings. All debt issued in 2009 is senior, unsecured and has been guaranteed by Roche Holding Ltd, the parent of the RHI Group.

Financing costs decreased by 35% to USD 0.3 billion in the first half of 2017 since there was no loss on early debt redemption as in the prior year. At June 30, 2017 debt was USD 39.1 billion compared to USD 40.8 billion at the end of 2016. This decrease was mainly due to payments of two term notes to related parties in amount of USD 875 million and USD 800 million respectively. A full analysis of financing costs is given in Note 3 to the RHI Interim Financial Statements.

The RHI Group's effective tax rate for the six months ended June 30, 2017 increased to 38.9% (six months ended June 30, 2016: 36.3%). Higher non-deductible tax losses and expenses contributed towards this increase.

Cash flow

The cash inflows from operating activities increased by USD 1.3 billion to USD 4.9 billion in the first half of 2017. This was mainly due to a lower increase in net working capital, increased cash generated from operations and decreased payments for defined benefit plans. The cash outflows from investing activities decreased by USD 0.4 billion to USD 0.5 billion mainly due to lower purchases of intangible assets and higher sales of marketable securities. The cash outflows from financing activities of USD 4.5 billion were mainly due to the repayment of related party bonds and notes of USD 1.7 billion, dividends paid to related parties of USD 1.0 billion, interest paid to third and related parties of USD 0.8 billion and cash pool contributions to related parties of USD 0.5 billion.

Financial position

In 2009 the Genentech transaction was accounted for in full as an equity transaction and as a consequence, the carrying amount of the consolidated equity of the RHI Group was significantly reduced (see Note 1 to the RHI Interim Financial Statements). At June 30, 2017 the RHI Group had a negative equity of USD 20.2 billion (December 31, 2016: USD 21.1 billion). The capacity of the RHI Group to generate positive cash flows and operating profit is not affected by this accounting treatment. In addition RHI has bonds, notes and commercial paper outstanding with a carrying value of USD 15.4 billion which are guaranteed by Roche Holding Ltd, the parent company of the Roche Group.

Total assets decreased by USD 0.9 billion to USD 32.9 billion at June 30, 2017 mainly due to a decrease in intangible assets partially offset by increases in accounts receivables. Total liabilities decreased by USD 1.8 billion to USD 53.1 billion at June 30, 2017 mainly due to a decrease in debt to related parties. At June 30, 2017 the carrying value of debt was USD 39.1 billion (December 31, 2016: USD 40.8 billion), of which USD 23.4 billion (December 31, 2016: USD 25.1 billion) is due to related parties.

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 RHI's counterparties. The RHI Group's financial risk management is described in Note 28 to the RHI Annual Financial Statements.

Uncertainties

Key accounting judgements, estimates and assumptions are described in Note 1 to the RHI Interim Financial Statements. Provisions and contingent liabilities are described in Note 19 to the RHI Annual Financial Statements and these are updated, where appropriate, in Note 9 to the RHI Interim Financial Statements.

3. Responsibility statement

The directors of Roche Holdings, Inc. confirm that, to the best of their knowledge as of the date of their approval of the Interim Consolidated Financial statements at July 28, 2017:

- the Interim Consolidated Financial Statements at June 30, 2017, which have been prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of Roche Holdings, Inc. and the undertakings included in the consolidation taken as a whole; and that
- the Management Report gives a true and fair view of the development and performance of the business and the position of Roche Holdings, Inc. and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Severin Schwan Chairman of the Board	Alan Hippe Vice Chairman of the Board	Bruce Resnick Member of the Board
Roger Brown Member of the Board	Sean A. Johnston Member of the Board	David P. McDede Member of the Board

Roche Holdings, Inc. Interim Consolidated Financial Statements

The Interim Consolidated Financial Statements have been reviewed by Roche Holdings, Inc.'s auditor and their review report is presented on page 27.

Roche Holdings, Inc. consolidated income statement for the six months ended June 30, 2017 *in millions of USD*

	Pharmaceuticals	Diagnostics	Corporate	RHI Group
Sales [2]	10,882	1,749	-	12,631
Royalties and other operating income [2]	2,049	109	-	2,158
Cost of sales	(4,904)	(1,020)	-	(5,924)
Marketing and distribution	(1,215)	(390)	-	(1,605)
Research and development	(2,568)	(264)	-	(2,832)
General and administration	(207)	(57)	(11)	(275)
Operating profit [2]	**4,037**	**127**	**(11)**	**4,153**
Financing costs [3]				(296)
Financing costs – related parties [15]				(520)
Other financial income (expense) [3]				79
Other financial income (expense) – related parties [15]				21
Profit before taxes				**3,437**
Income taxes [4]				(1,338)
Net income				**2,099**
Attributable to				
- Roche Holdings, Inc. shareholder				2,143
- Non-controlling interests				(44)

Roche Holdings, Inc. consolidated income statement for the six months ended June 30, 2016 *in millions of USD*

	Pharmaceuticals	Diagnostics	Corporate	RHI Group
Sales [2]	10,081	1,765	-	11,846
Royalties and other operating income [2]	1,999	67	-	2,066
Cost of sales	(3,498)	(1,008)	-	(4,506)
Marketing and distribution	(1,207)	(386)	-	(1,593)
Research and development	(2,235)	(282)	-	(2,517)
General and administration	(398)	(93)	(17)	(508)
Operating profit [2]	**4,742**	**63**	**(17)**	**4,788**
Financing costs [3]				(456)
Financing costs – related parties [15]				(523)
Other financial income (expense) [3]				(11)
Other financial income (expense) – related parties [15]				10
Profit before taxes				**3,808**
Income taxes [4]				(1,384)
Net income				**2,424**
Attributable to				
- Roche Holdings, Inc. shareholder				2,449
- Non-controlling interests				(25)

Roche Holdings, Inc. consolidated statement of comprehensive income *in millions of USD*

	Six months ended June 30, 2017	2016
Net income recognised in income statement	**2,099**	**2,424**
Other comprehensive income		
Remeasurements of defined benefit plans	(13)	(136)
Items that will never be reclassified to the income statement	**(13)**	**(136)**
Available-for-sale investments	(35)	(4)
Cash flow hedges	3	(7)
Currency translation of foreign operations	30	3
Items that are or may be reclassified to the income statement	**(2)**	**(8)**
Other comprehensive income, net of tax	**(15)**	**(144)**
Total comprehensive income	**2,084**	**2,280**
Attributable to		
- Roche Holdings, Inc. shareholder	2,128	2,305
- Non-controlling interests	(44)	(25)
Total	**2,084**	**2,280**

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

	June 30, 2017	December 31, 2016
Non-current assets		
Property, plant and equipment	6,719	6,657
Goodwill [7]	8,775	8,775
Intangible assets [8]	8,665	10,543
Deferred tax assets	-	-
Defined benefit plan assets	152	151
Other non-current assets	481	475
Other non-current assets – related parties [15]	-	-
Total non-current assets	**24,792**	**26,601**
Current assets		
Inventories	2,059	2,104
Accounts receivable – trade and other	2,842	2,426
Accounts receivable – related parties [15]	2,425	1,870
Current income tax assets	-	-
Other current assets	752	636
Other current assets – related parties [15]	-	-
Marketable securities	42	119
Cash and cash equivalents	-	70
Total current assets	**8,120**	**7,225**
Total assets	**32,912**	**33,826**
Non-current liabilities		
Long-term debt [10]	(12,620)	(12,490)
Long-term debt – related parties [15]	(18,700)	(22,078)
Deferred tax liabilities	(717)	(1,353)
Defined benefit plan liabilities	(1,977)	(1,960)
Provisions [9]	(655)	(612)
Other non-current liabilities	(319)	(335)
Other non-current liabilities – related parties [15]	(169)	(182)
Total non-current liabilities	**(35,157)**	**(39,010)**
Current liabilities		
Short-term debt [10]	(3,064)	(3,218)
Short-term debt – related parties [15]	(4,700)	(2,975)
Current income tax liabilities	(1,947)	(1,205)
Provisions [9]	(1,132)	(1,516)
Accounts payable – trade and other	(748)	(959)
Accounts payable – related parties [15]	(954)	(843)
Other current liabilities	(4,192)	(4,046)
Other current liabilities – related parties [15]	(1,217)	(1,168)
Total current liabilities	**(17,954)**	**(15,930)**
Total liabilities	**(53,111)**	**(54,940)**
Total net liabilities	**(20,199)**	**(21,114)**
Equity		
Capital and reserves attributable to Roche Holdings, Inc. shareholder	(20,351)	(21,301)
Equity attributable to non-controlling interests	152	187
Total equity	**(20,199)**	**(21,114)**

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

	Six months ended June 30, 2017	2016
Cash flows from operating activities		
Cash generated from operations [13]	6,769	6,309
(Increase) decrease in net working capital	(670)	(875)
(Increase) decrease in net working capital - related parties	185	(311)
Payments made for defined benefit plans	(103)	(256)
Utilisation of provisions	(142)	(243)
Disposal of products	1	-
Other operating cash flows	(1)	-
Cash flows from operating activities, before income taxes paid	**6,039**	**4,624**
Income taxes paid	(1,149)	(1,052)
Total cash flows from operating activities	**4,890**	**3,572**
Cash flows from investing activities		
Purchase of property, plant and equipment	(402)	(456)
Purchase of intangible assets	(108)	(300)
Disposal of property, plant and equipment	1	4
Disposal of intangible assets	3	11
Business combinations [5]	(98)	(71)
Divestment of subsidiaries [12]	8	-
Interest received	1	1
Interest received from related parties	11	4
Sales of equity securities and debt securities	90	-
Purchases of equity securities and debt securities	-	(19)
Other investing cash flows	28	(12)
Total cash flows from investing activities	**(466)**	**(838)**
Cash flows from financing activities		
Proceeds from issue of bonds and notes [10]	-	988
Proceeds from issue of related party debt [10]	-	750
Redemption and repurchase of bonds and notes [10]	-	(2,978)
Repayment of related party debt [10]	(1,675)	(500)
Increase (decrease) in commercial paper [10]	(153)	2,905
Increase (decrease) in other debt [10]	-	1
Hedging arrangements	-	-
Hedging arrangements - related parties	(1)	(401)
Interest paid	(283)	(450)
Dividends paid to related parties [11]	(1,000)	(1,650)
Interests and other financing - related parties	(539)	(565)
Recharges and prepayments to related parties for equity compensation plans	(381)	(238)
(Increase) decrease of cash pool balance with related parties [15]	(479)	(620)
Total cash flows from financing activities	**(4,511)**	**(2,758)**
Net effect of currency translation on cash and cash equivalents	1	8
Increase (decrease) in cash and cash equivalents	**(86)**	**(16)**
Cash and cash equivalents at beginning of period	70	46
Cash and cash equivalents at end of period [a)]	**(16)**	**30**

a) Cash overdrafts of USD 16 million (June 30, 2016: none) are included within other current liabilities in the balance sheet.

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

	Share capital	Retained earnings	Fair value reserves	Hedging reserves	Translation reserves	Total	Non-controlling interests	Total equity
Six months ended June 30, 2016								
At January 1, 2016	**1**	**(22,025)**	**53**	**35**	**2**	**(21,934)**	**231**	**(21,703)**
Net income recognised in income statement	-	2,449	-	-	-	2,449	(25)	2,424
Available-for-sale investments	-	-	(4)	-	-	(4)	-	(4)
Cash flow hedges	-	-	-	(7)	-	(7)	-	(7)
Currency translation of foreign operations	-	-	-	-	3	3	-	3
Remeasurements of defined benefit plans	-	(136)	-	-	-	(136)	-	(136)
Total comprehensive income	**-**	**2,313**	**(4)**	**(7)**	**3**	**2,305**	**(25)**	**2,280**
Dividends	-	(2,250)	-	-	-	(2,250)	-	(2,250)
Equity compensation plans	-	246	-	-	-	246	3	249
Changes in non-controlling interest	-	(3)	-	-	-	(3)	3	-
At June 30, 2016	**1**	**(21,719)**	**49**	**28**	**5**	**(21,636)**	**212**	**(21,424)**
Six months ended June 30, 2017								
At January 1, 2017	**1**	**(21,368)**	**43**	**43**	**(20)**	**(21,301)**	**187**	**(21,114)**
Net income recognised in income statement	-	2,143	-	-	-	2,143	(44)	2,099
Available-for-sale investments	-	-	(35)	-	-	(35)	-	(35)
Cash flow hedges	-	-	-	3	-	3	-	3
Currency translation of foreign operations	-	-	-	-	30	30	-	30
Remeasurements of defined benefit plans		(13)	-	-	-	(13)	-	(13)
Total comprehensive income	**-**	**2,130**	**(35)**	**3**	**30**	**2,128**	**(44)**	**2,084**
Dividends	-	(1,000)	-	-	-	(1,000)	-	(1,000)
Equity compensation plans	-	(174)	-	-	-	(174)	5	(169)
Changes in non-controlling interest	-	(4)	-	-	-	(4)	4	-
At June 30, 2017	**1**	**(20,416)**	**8**	**46**	**10**	**(20,351)**	**152**	**(20,199)**

Notes to the Roche Holdings, Inc. Interim Consolidated Financial Statements

1. Accounting policies

Basis of preparation

These financial statements are the unaudited condensed interim consolidated financial statements (hereafter 'the Interim Financial Statements') of Roche Holdings, Inc., a company incorporated in the State of Delaware, and its subsidiaries (hereafter 'RHI' or 'the RHI Group') for the six months ended June 30, 2017 (hereafter 'the interim period'). RHI is 100% indirectly owned by Roche Holding Ltd, a public company registered in Switzerland and parent company of the Roche Group. The RHI Group is therefore a member of the Roche Group. These Interim Financial Statements should be read in conjunction with the Consolidated Financial Statements for the year ended December 31, 2016 (hereafter 'the Annual Financial Statements'), as they provide an update of previously reported information. They were approved for issue by the Board of Directors on July 28, 2017.

Statement of compliance

The Interim Financial Statements have been prepared in accordance with IAS 34 'Interim Financial Reporting', as adopted by the European Union (EU). They do not include all of the information required for a complete set of IFRS financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the RHI Group since the Annual Financial Statements.

Going concern

The RHI Group completed the purchase of the non-controlling interests in Genentech, effective March 26, 2009. Based on the International Accounting Standard 27 'Consolidated and Separate Financial Statements' (IAS 27) and consistent with the International Financial Reporting Standard 10 'Consolidated Financial Statements' (IFRS 10), this transaction was accounted for in full as an equity transaction. As a consequence, the carrying amount of the consolidated equity of the RHI Group at that time was reduced by USD 46.6 billion, of which USD 7.6 billion was allocated to eliminate the book value of Genentech non-controlling interests. At June 30, 2017 the RHI Group had a negative equity of USD 20.2 billion (December 31, 2016: USD 21.1 billion). The capacity of the RHI Group to generate positive cash flows and operating profit is not affected by this accounting treatment. In addition, RHI has bonds, notes and commercial paper outstanding with a carrying value of USD 15.4 billion which are guaranteed by Roche Holding Ltd. Management has assessed that it remains appropriate to prepare the RHI Group's financial statements on a going concern basis. In the 2017 interim period, the RHI Group generated an operating profit of USD 4.2 billion and a positive operating cash flow of USD 4.9 billion.

Management judgements and estimates

The preparation of the Interim Financial Statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of revenues, expenses, assets, liabilities and related disclosures. If in the future such estimates and assumptions, which are based on management's best judgement at the date of the Interim Financial Statements, deviate from the actual circumstances, the original estimates and assumptions will be modified as appropriate in the period in which the circumstances change. The significant judgements made by management in applying the RHI Group's accounting policies and the key sources of estimation uncertainty are the same as those applied in the Annual Financial Statements.

Seasonality

The RHI Group operates in industries where significant seasonal or cyclical variations in total sales are not experienced during the financial year.

Significant accounting policies

Except as described below, the accounting policies applied in these Interim Financial Statements are the same as those applied in the Annual Financial Statements. Changes in accounting policies will be reflected in the RHI Group's Consolidated Financial Statements for the year ended December 31, 2017.

Changes in accounting policies

In 2017 the RHI Group has implemented various minor amendments to existing standards and interpretations, which have no material impact on the RHI Group's overall results and financial position.

Future new and revised standards

The RHI Group is currently assessing the potential impacts of the various new and revised standards and interpretations that will be mandatory from January 1, 2018 and beyond after 2018, notably IFRS 9 'Financial Instruments', IFRS 15 'Revenues from Contracts with Customers' and IFRS 16 'Leases' as summarised below.

IFRS 9 'Financial Instruments'. IFRS 9 Financial Instruments (issued by the IASB on July 24, 2014) has been endorsed by the EU on November 22, 2016 and becomes effective January 1, 2018.

RHI plans to implement the new standard effective January 1, 2018 and will apply the exemption from full retrospective application for the classification and measurement requirements, including impairment, meaning that the RHI Group does not currently anticipate that the comparative 2017 results will be restated when the new standard is applied. The hedge accounting requirements will be applied prospectively. The new standard will result in an increased volume of disclosure information in the Annual Financial Statements.

The standard deals with the classification, recognition and measurement (including impairment) of financial instruments. Gains and losses which the RHI Group currently recognises in the statement of other comprehensive income on remeasuring assets classified as 'available-for-sale' will in future be recognised in the income statement for those assets which will be classified at fair value through profit and loss and for equities where the fair value through other comprehensive income irrevocable option will not be used. Impairment of financial assets, including trade and lease receivables will be assessed using an expected loss model rather than an incurred loss model. RHI is assessing the potential impact from using the expected loss model, but currently anticipates that the new impairment requirements will not have a material impact on RHI's overall results and financial position. The new standard also introduces a new hedge accounting model, which requires hedge accounting relationships to be based upon the RHI Group's own risk management strategy and objectives and to be discontinued only when the relationships no longer qualify for hedge accounting. The Group's initial assessment is that the existing hedge relationships will continue to be designated as such under the new hedge accounting requirements.

IFRS 15 'Revenues from Contracts with Customers'. IFRS 15 Revenue from Contracts with Customers (issued by the IASB on May 28, 2014) and the 'Amendments to IFRS15: Effective date of IFRS 15' (issued by the IASB on September 11, 2015) have been endorsed by the EU on September 22, 2016 and become effective January 1, 2018. The 'Clarifications to IFRS 15' (issued by the IASB on April 12, 2016) have not yet been endorsed by the EU.

RHI plans to implement the new standard effective January 1, 2018 and will apply the full-retrospective method for the transition. RHI does not anticipate that the new standard will change the amounts of revenue recognised for 2017 and therefore then no restatement should be necessary. The RHI Group also plans to use the practical expedient to not disclose the amount of the transaction price allocated to remaining performance obligations for 2017. The new standard will result in an increased volume of disclosure information in the Annual Financial Statements.

The new standard contains a new set of principles on when and how to recognise and measure revenue as well as new requirements related to presentation. The core principle in that framework is that revenue should be recognised dependent on the transfer of promised goods or services to the customer for an amount that reflects the consideration to which should be received in exchange for those goods or services. The objective of the standard is to provide a five-step approach to revenue recognition that includes identifying contracts with customers, identifying performance obligations, determining transaction prices, allocating transaction prices to performance obligations, and recognising revenue when or as performance obligations are satisfied.

IFRS 16 'Leases'. IFRS 16 'Leases' (issued by the IASB on January 13, 2016) has not yet been endorsed by the EU.

RHI plans to implement the new standard effective January 1, 2019 and will apply the cumulative catch-up option for the transition, meaning that the comparative 2018 results will not be restated when the new standard is applied. The new standard will result in an increased volume of disclosure information in the Annual Financial Statements.

The main impact of the new standard will be to bring operating leases on-balance sheet. RHI is assessing the potential impact, but currently anticipates that the new standard will result in the carrying value of property, plant and equipment being increased by at least USD 0.3 billion, with debt increased by a similar amount at the date of implementation. In addition, the application of the new standard will result in part of what are currently reported as operating lease costs being recorded as interest expenses. Given the leases involved and the current low interest rate environment RHI does not currently expect this effect to be material.

2. Operating segment information

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 revenues from the sale or licensing of products or technology to third parties. Certain corporate activities that cannot be reasonably allocated to the other reportable business segments based on RHI's management and organisational structure are reported as 'Corporate'. These include certain functions for communications, human resources, finance (including treasury, taxes and pension fund management), legal, safety and environmental services.

Divisional information *in millions of USD*

	Pharmaceuticals		Diagnostics		Corporate		RHI Group	
Six months ended June 30,	2017	2016	2017	2016	2017	2016	2017	2016
Revenues from external customers and related parties								
Sales	10,882	10,081	1,749	1,765	-	-	12,631	11,846
Royalties and other operating income	2,049	1,999	109	67	-	-	2,158	2,066
Total	**12,931**	**12,080**	**1,858**	**1,832**	**-**	**-**	**14,789**	**13,912**
Segment results								
Operating profit	4,037	4,742	127	63	(11)	(17)	4,153	4,788

Net operating assets *in millions of USD*

	Assets		Liabilities		Net assets	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Pharmaceuticals	22,261	23,410	(5,739)	(5,676)	16,522	17,734
Diagnostics	9,042	9,125	(1,601)	(1,794)	7,441	7,331
Corporate	28	29	(144)	(153)	(116)	(124)
Total operating	**31,331**	**32,564**	**(7,484)**	**(7,623)**	**23,847**	**24,941**
Non-operating	1,581	1,262	(45,627)	(47,317)	(44,046)	(46,055)
RHI Group	**32,912**	**33,826**	**(53,111)**	**(54,940)**	**(20,199)**	**(21,114)**

Supplementary revenues information

Revenues from product sales are recorded net of allowances for estimated rebates, chargebacks, cash discounts and estimates of product returns, all of which are established at the time of sale. All product sales allowances are based on estimates of the amounts earned or to be claimed on the related sales. These estimates take into consideration historical experience, current contractual and statutory requirements, specific known market events and trends such as competitive pricing and new product introductions, estimated inventory levels, and the shelf life of products. If actual future results vary, these estimates are adjusted and may have an effect on sales and earnings in the period of the adjustment.

The gross-to-net sales reconciliation for the Pharmaceuticals Division is shown in the table below. The companies in the Diagnostics Division have similar reconciling items, but at much lower amounts.

Pharmaceuticals Division sales gross-to-net reconciliation *in millions of USD*

	Six months ended June 30,	
	2017	2016
Gross sales	13,291	11,887
Government and regulatory mandatory price reductions	(2,293)	(1,832)
Contractual price reductions	(498)	(379)
Cash discounts	(117)	(101)
Customer returns reserves	(30)	(60)
Others	(116)	(74)
Net sales to third parties	**10,237**	**9,441**
Net sales to related parties	645	640
Net sales	**10,882**	**10,081**

Government and regulatory mandatory price reductions. These consist of mandatory price reductions. The major elements are 340B Drug Discount Program, Medicaid and other plans in the US, which totalled USD 2.3 billion (six months ended June 30, 2016: USD 1.8 billion).

Contractual price reductions. These include rebates and chargebacks that are the result of contractual agreements that are primarily volume-based and performance-based.

Cash discounts. These include credits offered to wholesalers for remitting payment on their purchases within contractually defined incentive periods.

Customer returns reserves. These are allowances established for expected product returns.

Sales reductions that are expected to be withheld by the customer upon settlement, such as contractual price reductions and cash discounts, are recorded in the balance sheet as a deduction from trade receivables. Sales reductions that are separately payable to customers, such as governmental health authorities or healthcare regulatory authorities are recorded in the balance sheet as accrued liabilities. Provisions for sales returns are recorded in the balance sheet as other provisions.

Revenues – Royalties and other operating income *in millions of USD*

	Six months ended June 30,	
	2017	2016
Royalty income	757	787
Royalty income from related parties [15]	1,268	1,162
Income from out-licensing agreements	44	47
Income from disposal of products and other	89	70
Total royalty and other operating income	**2,158**	**2,066**

3. Net financial expense

Financing costs *in millions of USD*

	Six months ended June 30,	
	2017	2016
Interest expense	(249)	(290)
Amortisation of debt discount [10]	(5)	(7)
Net gains (losses) on redemption and repurchase of bonds and notes [10]	-	(102)
Discount unwind	(9)	(19)
Net interest cost of defined benefit plans	(33)	(38)
Total financing costs	**(296)**	**(456)**

Other financial income (expense) *in millions of USD*

	Six months ended June 30,	
	2017	2016
Net gains (losses) on sale of equity securities	81	1
Write-downs and impairments of equity securities	-	(1)
Net income from equity securities	**81**	**-**
Net interest income	1	1
Foreign exchange gains (losses)	(10)	(9)
Net other financial income (expense)	7	(3)
Total other financial income (expense)	**79**	**(11)**

Net financial expense *in millions of USD*

	Six months ended June 30,	
	2017	2016
Financing costs	(296)	(456)
Other financial income (expense)	79	(11)
Net financial expense	**(217)**	**(467)**
Financial result from Treasury management	(184)	(429)
Financial result from Pension management	(33)	(38)
Net financial expense	**(217)**	**(467)**

4. Income taxes

Income tax expense is recognised based upon management's best estimate of the weighted average annual income tax rate expected for the full financial year multiplied by the pre-tax income for the six months ended June 30, 2017.

Income tax expenses *in millions of USD*

	Six months ended June 30,	
	2017	2016
Current income taxes	(1,973)	(1,647)
Deferred taxes	635	263
Total income tax (expense)	**(1,338)**	**(1,384)**

The RHI Group's effective tax rate for the six months ended June 30, 2017 increased to 38.9% (six months ended June 30, 2016: 36.3%). Higher non-deductible tax losses and expenses contributed towards this increase.

5. Business combinations

Acquisitions – 2017

The RHI Group did not complete any business combinations during the six months ended June 30, 2017.

Acquisitions – 2016

The RHI Group did not complete any business combinations during the six months ended June 30, 2016.

Cash flows from business combinations

Acquisitions: net cash outflow *in millions of USD*

	Six months ended June 30, 2017			Six months ended June 30, 2016		
	Pharmaceuticals	Diagnostics	Total	Pharmaceuticals	Diagnostics	Total
Cash consideration paid	-	-	-	-	-	-
Deferred consideration paid	-	-	-	-	-	-
Contingent consideration paid [14]	-	(98)	(98)	-	(71)	(71)
Cash in acquired company	-	-	-	-	-	-
Transaction costs	-	-	-	-	-	-
Total net cash outflow	**-**	**(98)**	**(98)**	**-**	**(71)**	**(71)**

6. Restructuring plans

During the six months ended June 30, 2017 the RHI Group continued with the implementation of several major restructuring plans initiated in prior years.

Restructuring plans: costs incurred *in millions of USD*

	Diagnostics	Site consolidation	Other Plans	Total
Six months ended June 30, 2017				
Restructuring costs				
- Employee-related costs	31	2	3	36
- Site closure costs	4	6	-	10
- Divestment of products and businesses	-	3	-	3
- Other reorganisation expenses	8	2	2	12
Total restructuring costs	**43**	**13**	**5**	**61**
Six months ended June 30, 2016				
Restructuring costs				
- Employee related costs	3	(2)	7	8
- Site closure costs	-	37	-	37
- Other reorganisation expenses	4	2	7	13
Total restructuring costs	**7**	**37**	**14**	**58**

The major items of expenditure in the six months ended June 30, 2017 were:

- **Diagnostics Plans.** Strategy plans in the Diagnostics Division that were launched in 2016 incurred costs of USD 37 million mainly for employee-related costs.
- **Site Consolidation Plans.** The strategic realignment of the Pharmaceuticals Division's manufacturing network incurred costs of USD 13 million mainly related to other site closure costs and other reorganization expenses. The divestment of Roche Carolina Inc., the subsidiary at the Florence site, has been completed with a loss on divestment of USD 3 million (see Note 12), which is included in this USD 13 million of costs.

Restructuring plans: summary of costs incurred *in millions of USD*

	Six months ended June 30, 2017	Six months ended June 30, 2016
Employee-related costs		
- Termination costs	32	9
- Other employee-related costs	4	(1)
Total employee-related costs	**36**	**8**
Site closure costs		
- Impairment of property, plant and equipment	2	10
- Accelerated depreciation of property, plant and equipment	-	15
- Other site closure costs	8	12
Total site closure costs	**10**	**37**
Loss on divestment of subsidiary[12]	3	-
Total costs on divestment of products and businesses	**3**	**-**
Other reorganisation expenses	12	13
Total restructuring costs	**61**	**58**

Restructuring plans: classification of costs *in millions of USD*

	Six months ended June 30, 2017			Six months ended June 30, 2016		
	Depreciation, amortisation and impairment	Other costs	Total	Depreciation, amortisation and impairment	Other costs	Total
Cost of sales						
- Pharmaceuticals	1	8	9	25	13	38
- Diagnostics	1	14	15	-	1	1
Marketing and distribution						
- Pharmaceuticals	-	-	-	-	-	-
- Diagnostics	-	23	23	-	4	4
Research and development						
- Pharmaceuticals	-	1	1	-	1	1
- Diagnostics	-	4	4	-	1	1
General and administration						
- Pharmaceuticals	-	7	7	-	9	9
- Diagnostics	-	1	1	-	2	2
- Corporate	-	1	1	-	2	2
Total	**2**	**59**	**61**	**25**	**33**	**58**
Total by operating segment						
- Pharmaceuticals	1	16	17	25	23	48
- Diagnostics	1	42	43	-	8	8
- Corporate	-	1	1	-	2	2
Total	**2**	**59**	**61**	**25**	**33**	**58**

7. Goodwill

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

Six months ended June 30, 2017	
At January 1, 2017	8,775
At June 30, 2017	**8,775**
Allocated by operating segment	
Pharmaceuticals	4,823
Diagnostics	3,952
Total RHI Group	**8,775**

8. Intangible assets

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

	Product intangibles: in use	Product intangibles: not available for use	Marketing intangibles: in use	Technology intangibles: in use	Total
Six months ended June 30, 2017					
At January 1, 2017	7,726	2,701	13	103	10,543
Additions	3	142	-	8	153
Disposals	(3)	-	-	-	(3)
Transfers	464	(499)	-	35	-
Amortisation charge	(769)	-	(1)	(22)	(792)
Impairment charge	(983)	(328)	-	-	(1,311)
Currency translation effects	75	-	-	-	75
At June 30, 2017	**6,513**	**2,016**	**12**	**124**	**8,665**
Allocated by operating segment					
Pharmaceuticals	5,039	1,328	-	91	6,458
Diagnostics	1,474	688	12	33	2,207
Total RHI Group	**6,513**	**2,016**	**12**	**124**	**8,665**

Classification of intangible asset amortisation and impairment expenses *in millions of USD*

	Amortisation		Impairment	
Six months ended June 30,	2017	2016	2017	2016
Cost of sales				
- Pharmaceuticals	(660)	(648)	(983)	-
- Diagnostics	(91)	(102)	-	-
Marketing and distribution				
- Pharmaceuticals	-	-	-	-
- Diagnostics	(1)	(1)	-	-
Research and development				
- Pharmaceuticals	(38)	(39)	(328)	(56)
- Diagnostics	(2)	-	-	-
Total	**(792)**	**(790)**	**(1,311)**	**(56)**

Impairment charges – 2017

Pharmaceuticals Division. Impairment charges totalling USD 1,311 million were recorded related to:

- A charge of USD 983 million for the partial impairment of the product intangible in use acquired as part of the InterMune acquisition. The asset concerned was written down to its estimated recoverable value of USD 4,145 million as at June 30, 2017. The main factor leading to this was lower-than-expected sales of Esbriet in the first half of 2017 relative to the most recent long-term forecasts. The next long-term forecasts will be prepared in the second half of 2017 and depending upon any revised estimates for Esbriet in those forecasts, the intangible asset may require further testing for impairment or reversal of impairment in the 2017 Annual Financial Statements. In the meantime the intangible asset continues to be amortised over its remaining estimated useful life of four years.
- A charge of USD 140 million due to the decision to stop development of one compound with an alliance partner following an assessment of clinical and non-clinical data. The asset concerned, which was not yet being amortised, was fully written down.
- A charge of USD 111 million due to the launch of a competitor product for the compound acquired as part of the Trophos acquisition. The asset concerned, which was not yet being amortised, was written down to its estimated recoverable value of USD 58 million.
- A charge of USD 34 million due to the decision to stop development of one compound acquired as part of the Dutalys acquisition. The asset concerned, which was not yet being amortised, was fully written down.
- A charge of USD 23 million due to the decision to stop development of one compound with an alliance partner. The asset concerned, which was not yet being amortised, was fully written down.
- A charge of USD 20 million due to the decision to stop development of one compound acquired as part of the Santaris acquisition following a clinical data assessment. The asset concerned, which was not yet being amortised, was fully written down.

Impairment charges – 2016

Pharmaceuticals Division. Impairment charges totalling USD 56 million were recorded related to:

- A delay in the development of one compound following regulatory feedback (USD 28 million). The asset concerned, which was not yet being amortised, was partially written down.
- A decision to stop development of one compound (USD 28 million). The asset concerned, which was not yet being amortised, was fully written down.

9. Provisions and contingent liabilities

Provisions *in millions of USD*

	June 30, 2017	December 31, 2016
Legal provisions	414	609
Environmental provisions	181	196
Restructuring provisions	45	67
Contingent consideration provisions [14]	555	657
Other provisions	592	599
Total provisions	**1,787**	**2,128**
Current	1,132	1,516
Non-current	655	612
Total provisions	**1,787**	**2,128**

The RHI Group has revised the presentation of provisions. Contingent consideration provisions are now presented separately and employee provisions are now included as part of 'Other provisions'. The comparative period information has been restated accordingly.

During the six months ended June 30, 2017 USD 240 million of provisions were utilised (six months ended June 30, 2016: USD 314 million), mainly related to the utilisation of contingent consideration, restructuring, environmental and other provisions.

As part of the regular review of litigation matters, management has reassessed the provisions recorded for certain litigation matters. Based on the development of the various litigations, notably the Accutane case, some of the provisions previously held were released resulting in an income of USD 203 million for the six months ended June 30, 2017.

Further information on the contingent consideration provisions is disclosed in Note 14.

Other than as described below, no significant changes in the RHI Group's contingent liabilities or provisions for legal cases have occurred since the approval of the Annual Financial Statements by the Board of Directors.

Accutane. The litigation related to Accutane is described in Note 19 to the Annual Financial Statements.

At December 31, 2016 there was one case on appeal (USD 25 million) where a jury in the New Jersey Superior Court had ruled in favour of the plaintiff and subsequently had its verdict reversed in favour of Hoffmann-La Roche Inc. ('HLR'). In January 2017 the New Jersey Supreme Court reinstated the case and remanded the case to the Appellate Division for consideration of other issues. In May 2017 the Appellate Division again ruled in favour of HLR, reversed the verdict and remanded for a new trial; plaintiff has appealed that decision.

During February and March 2017, the Superior Court of New Jersey, Law Division, Atlantic County, held an evidentiary hearing on whether plaintiffs' experts can testify that Accutane causes ulcerative colitis. In April 2017, the Superior Court barred plaintiffs' experts because their methods did not meet the requirements for scientific reliability. In May 2017, the Superior Court entered an order dismissing 3,231 ulcerative colitis cases that were subject to the Superior Court's April 2017 order. The plaintiffs have appealed.

On July 25, 2017, the New Jersey Appellate Division affirmed the dismissal of 197 cases and reinstated judgments in 335 cases based on the strength of HLR's warnings after 2002. HLR is considering whether to appeal this ruling to the New Jersey Supreme Court, but these cases should be separately subject to dismissal under the ruling mentioned above regarding ulcerative colitis or under an earlier decision currently on appeal involving Crohn's disease.

As at the date of the Interim Financial Statements HLR was defending 3 actions involving 3 plaintiffs brought in various state courts throughout the US for personal injuries allegedly resulting from their use of Accutane in addition to the approximately 6,130 cases in the appeal process. If any cases survive the appeals, additional trials may be scheduled. 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 Group continues to defend vigorously the remaining personal injury cases and claims. Based on the development of the litigation some of the provisions previously held were released during the six months ended June 30, 2017.

In addition, the matters listed below do not currently have provisions recorded, but there are potential future obligations which will be confirmed only by the occurrence or non-occurrence of uncertain future events, or present obligations which cannot be measured with sufficient reliability.

Emicizumab litigation. On May 4, 2017 Baxalta Inc. ('Baxalta'), a subsidiary of Shire plc., filed a patent infringement and declaratory judgment of patent infringement suit in the US District Court for the District of Delaware, alleging that Genentech and Chugai Pharmaceutical Co., Ltd. currently or imminently would manufacture, use, sell, offer for sale, or import into the US emicizumab, which would infringe Baxalta's US Patent No. 7,033,590. Baxalta is seeking a judgment of infringement, injunctive and monetary relief, attorneys' fees, costs and expenses. On May 11, 2017 Genentech was served with the complaint. Genentech's response and counterclaims to the complaint were filed on June 30, 2017. The outcome of this matter cannot be determined at this time.

Securities litigation. On June 6, 2017 a class action was filed in the United States District Court for the District of New Jersey against Roche Holding Ltd and two of its current officers. The lawsuit brings claims under the federal securities laws in connection with the Roche Group's public disclosures, in particular with respect to matters relating to two of Roche's drugs, Herceptin and Perjeta. None of the defendants has yet been served. Other substantially similar lawsuits may follow. The Roche Group will vigorously defend itself in this matter. The outcome of this matter cannot be determined at this time.

There have been certain procedural developments in the other significant litigation matters described in Note 19 to the Annual Financial Statements. These do not significantly affect the assessment of the RHI Group's management concerning the adequacy of the total provisions recorded for legal matters.

10. Debt

Debt: movements in carrying value of recognised liabilities *in millions of USD*

Six months ended June 30, 2017	
At January 1, 2017	40,761
Proceeds from issue of bonds and notes	-
Redemption and repurchase of bonds and notes	-
Increase (decrease) in commercial paper	(153)
Increase (decrease) in amounts due to related parties	(1,675)
Increase (decrease) in other debt	-
Net (gains) losses on redemption and repurchase of bonds and notes [3]	-
Amortisation of debt discount [3]	5
Net foreign exchange (gains) losses	124
Currency translation effects and other	22
At June 30, 2017	**39,084**
Bonds and notes	13,769
Commercial paper	1,915
Amounts due to related parties [15]	23,400
Total debt	**39,084**
Long-term debt	31,320
Short-term debt	7,764
Total debt	**39,084**

Issuance of bonds and notes - 2017

The RHI Group did not issue any bonds or notes during the six months ended June 30, 2017.

Issuance of bonds and notes - 2016

During the six months ended June 30, 2016 the RHI Group completed an offering of USD 1.0 billion fixed rate notes with a coupon of 2.625%.

Redemption and repurchase of bonds and notes – 2017

The RHI Group did not redeem any bonds or notes during the six months ended June 30, 2017.

Redemption and repurchase of bonds and notes – 2016

During the six months ended June 30, 2016 the RHI Group completed the early redemption of USD 600 million fixed rate notes, completed the redemption of the EUR 2.1 billion fixed rate notes and initiated the early partial redemption of USD 857 million fixed rate notes (completed in August 2016).

Cash flows from issuance, redemption and repurchase of bonds and notes

Cash inflows from issuance of bonds and notes *in millions of USD*

	Six months ended June 30,	
	2017	2016
US dollar notes	-	988
Total cash inflows from issuance of bonds and notes	**-**	**988**

Cash outflows from redemption and repurchase of bonds and notes *in millions of USD*

	Six months ended June 30,	
	2017	2016
Euro Medium Term Note programme – Euro notes	-	(2,301)
US dollar notes	-	(677)
Total cash outflows from redemption and repurchase of bonds and notes	**-**	**(2,978)**

Commercial paper

Roche Holdings, Inc. commercial paper program. Roche Holdings, Inc. has an established commercial paper program under which it can issue up to USD 7.5 billion of unsecured commercial paper notes guaranteed by Roche Holding Ltd. A committed credit line of USD 7.5 billion is available as a back-stop line. The maturity of the notes under the program cannot exceed 365 days from the date of issuance. At June 30, 2017 unsecured commercial paper notes with a principal amount of USD 1.9 billion and an average interest rate of 1.02% were outstanding.

Movements in commercial paper obligations *in millions of USD*

Six months ended June 30, 2017	
At January 1, 2017	2,068
Net cash proceeds (payments)	(153)
At June 30, 2017	**1,915**

Recognised liabilities due to related parties

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

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

Six months ended June 30, 2017	
At January 1, 2017	25,053
Cash inflows from related parties	-
Cash outflows to related parties	(1,675)
Currency translation of foreign operations	22
At June 30, 2017	**23,400**

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*

	Six months ended June 30,	
	2017	2016
Term note 3.41% issued February 26, 2016	-	750
Total	**-**	**750**

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*

	Six months ended June 30,	
	2017	2016
Term note 1.39% due January 14, 2016	-	(500)
Term note 2.27% due April 6, 2017	(875)	-
Term note 2.39% due June 14, 2017	(800)	-
Total	**(1,675)**	**(500)**

11. Equity attributable to RHI shareholder

Genentech transaction

The RHI Group completed the purchase of the non-controlling interest in Genentech effective March 26, 2009. Based on the International Accounting Standard 27 'Consolidated and Separate Financial Statements' (IAS 27) and consistent with the International Financial Reporting Standard 10 'Consolidated Financial Statements' (IFRS 10), this transaction was accounted for in full as an equity transaction. As a consequence, the carrying amount of the consolidated equity of the RHI Group at that time was reduced by USD 46.6 billion, of which USD 7.6 billion was allocated to eliminate the book value of Genentech non-controlling interest. At June 30, 2017 the RHI Group had a negative equity of USD 20.2 billion (December 31, 2016: USD 21.1 billion). The capacity of the RHI Group to generate positive cash flows and operating profit is not affected by this accounting treatment.

Share capital

At June 30, 2017 the share capital of Roche Holdings, Inc., which is the RHI Group's parent company, consisted of 1,000 shares with a nominal value of USD 1,000 each and has not changed during the first half of 2017. All shares are indirectly owned by Roche Holding Ltd, a public company registered in Switzerland.

Dividends

On March 2, 2017 the Board of Directors of RHI resolved to declare a dividend of USD 1.0 million per share to RHI's sole stockholder, Roche Finance Ltd, which has been paid in the first half of 2017. On July 7, 2017 the Board of Directors of RHI resolved to declare a dividend of USD 1.0 million per share to RHI's sole stockholder, Roche Finance Ltd.

Own equity instruments

The RHI Group holds none of its own equity shares.

Retained earnings

In addition to net income attributable to the RHI shareholder of USD 2,099 million (six months ended June 30, 2016: USD 2,424 million) and the dividend payments described above, retained earnings also includes losses on remeasurements of defined benefit plans of USD 13 million, after tax (six months ended June 30, 2016: losses of USD 136 million, after tax).

12. Subsidiaries

Foundation Medicine, Inc.

Foundation Medicine, Inc. ('FMI') is a fully consolidated subsidiary of the RHI Group and at June 30, 2017 the RHI Group's interest in FMI was 57.3% (December 31, 2016: 58.4%). The common stock of FMI is publicly traded and is listed on the Nasdaq under the stock code 'FMI'. FMI prepares financial statements in accordance with US GAAP that are filed on a quarterly basis with the SEC.

Divestment of subsidiary

On February 1, 2017 the RHI Group sold its wholly owned subsidiary Roche Carolina Inc. in Florence, US, to a third party as part of the previously announced Pharmaceuticals Division's strategic realignment of its manufacturing network. The total consideration received was USD 8 million in cash. The total loss on divestment of USD 3 million, as shown in the table below, was reported as restructuring costs in the Roche Pharmaceuticals operating segment and included in general and administration.

Loss on divestment of subsidiary – 2017 *in millions of USD*

Consideration	**8**
Property, plant and equipment	1
Other net assets (liabilities)	8
Total net assets disposed	**9**
Provisions and accruals for residual obligations retained by the RHI Group	(2)
Loss on divestment of subsidiary [6]	**(3)**

13. Statement of cash flows

Cash generated from operations *in millions of USD*

	Six months ended June 30,	
	2017	2016
Net income	2,099	2,424
Add back non-operating (income) expense		
- Financing costs [3]	296	456
- Financing costs – related parties [15]	520	523
- Other financial income (expense) [3]	(79)	11
- Other financial income (expense) – related parties [15]	(21)	(10)
- Income taxes [4]	1,338	1,384
Operating profit	**4,153**	**4,788**
Depreciation of property, plant and equipment	288	287
Amortisation of intangible assets	792	790
Impairment of goodwill	-	-
Impairment of intangible assets	1,311	56
Impairment of property, plant and equipment	3	10
Operating (income) expenses for defined benefit plans	64	59
Operating expense for equity-settled equity compensation plans	165	153
Net (income) expense for provisions	(110)	119
Bad debt (reversal) expense	-	(1)
Inventory write-downs	99	48
Net (gain) loss on disposal of products	(1)	-
Other adjustments	5	-
Cash generated from operations	**6,769**	**6,309**

14. Financial risk management

The RHI Group's financial risk management objectives and policies are consistent with those disclosed in Note 28 to the Annual Financial Statements.

Fair value hierarchy

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2 – observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level 3 – unobservable inputs.

Fair value hierarchy of financial instruments *in millions of USD*

	Level 1	Level 2	Level 3	Total
At June 30, 2017				
Marketable securities				
- Equity securities	2	-	-	2
- Debt securities	40	-	-	40
Derivative financial instruments – related parties [15]	-	6	-	6
Available-for-sale investments – held at fair value	-	8	-	8
Financial assets recognised at fair value	**42**	**14**	**-**	**56**
Derivative financial instruments	-	-	-	-
Derivative financial instruments – related parties [15]	-	(97)	-	(97)
Contingent consideration	-	-	(555)	(555)
Financial liabilities recognised at fair value	**-**	**(97)**	**(555)**	**(652)**

At June 30, 2017 Level 1 financial assets consist of treasury bills, bonds and quoted shares. Level 2 financial assets consist primarily of commercial paper, certificates of deposit and derivative financial instruments.

The RHI Group determines Level 2 fair values using the following valuation techniques:

- Marketable securities and derivative financial instruments are based on valuation models that use observable market data for interest rates, yield curves, foreign exchange rates and implied volatilities for similar instruments at the measurement date.
- Available-for-sale investments using a valuation model derived from the most recently published observable financial prices.

The RHI Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the transfer has occurred. There were no significant transfers between Level 1 and Level 2 during the six months ended June 30, 2017.

Level 3 fair values

Details of the determination of Level 3 fair value measurements are set out below.

Contingent consideration arrangements *in millions of USD*

Six months ended June 30, 2017	
At January 1, 2017	(657)
Utilised [5]	98
Total unrealised gains and losses included in the income statement	
- Unused amounts reversed – recorded within general and administration	10
- Additional amounts created – recorded within general and administration	
- Discount unwind included in financing costs	(6)
At June 30, 2017	**(555)**

During the six months ended June 30, 2017 contingent consideration provisions decreased mainly due to the payment of milestones. Payments of USD 98 million were made for milestones related to the Genia, Ariosa and other acquisitions.

Contingent consideration arrangements

The RHI Group is party to certain contingent consideration arrangements arising from business combinations. The fair values are determined considering the expected payments, discounted to present value using risk-adjusted average discount rate of 4.1% at June 30, 2017 (December 31, 2016: 3.6%). The expected payments are determined by considering the possible scenarios of forecast sales and other performance criteria, the amount to be paid under each scenario, and the probability of each scenario. The significant unobservable inputs are the forecast sales, other performance criteria and the risk-adjusted discount rate. The estimated fair value would increase if the forecast sales or other performance criteria rates were higher or the risk-adjusted discount rate was lower. At June 30, 2017 the total payments under contingent consideration arrangements could be up to USD 1.7 billion (December 31, 2016: USD 1.8 billion).

Carrying value and fair value

At June 30, 2017 the carrying value of bonds and notes is USD 13.8 billion compared to a fair value of USD 14.9 billion and the carrying value of total debt is USD 39.1 billion compared to a fair value of USD 40.2 billion. The carrying values of financial assets are a reasonable approximation of the fair values at June 30, 2017.

15. Related parties

Controlling shareholder

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, allocation of other expenses attributable to the US business and the payment and receipt of royalties.

Related party transactions *in millions of USD*

	Six months ended June 30,	
	2017	2016
Sales	971	980
Royalty income	1,268	1,162
Contract revenue	4	19
Purchases of inventory and other materials	(255)	(300)
Reimbursements received under research and development cost-sharing and collaboration agreements	399	463
Payments issued under research and development cost-sharing and collaboration agreements	(573)	(704)
Reimbursements received under marketing and distribution cost-sharing and collaboration agreements	182	185
Services rendered	87	63
Services received	(71)	(85)
Other income (expense)	9	8
Financing costs – related parties		
Interest expense	(494)	(491)
Guarantee fees	(26)	(32)
Total financing costs – related parties	**(520)**	**(523)**
Other financial income (expense) – related parties		
Net gains (losses) on foreign currency derivatives	10	6
Other financial income (expense)	11	4
Total other financial income (expense) – related parties	**21**	**10**

Related party balances *in millions of USD*

	June 30, 2017	December 31, 2016
Other non-current assets	-	-
Other current assets	-	-
Accounts receivable	2,425	1,870
- of which derivative financial assets [14]	*6*	-
Total receivable – related parties	**2,425**	**1,870**
Long-term debt	(18,700)	(22,078)
Short-term debt	(4,700)	(2,975)
Total debt – related parties	**(23,400)**	**(25,053)**
Other non-current liabilities	(169)	(182)
Other current liabilities	(1,217)	(1,168)
Accounts payable	(954)	(843)
- of which derivative financial liabilities [14]	*(97)*	*(221)*
Total payable – related parties	**(2,340)**	**(2,193)**

The RHI Group deposits surplus funds with Roche Pharmholding B.V. in its function as corporate cash pool leader for numerous Roche affiliates. Amounts deposited of USD 1.4 billion (December 31, 2016: USD 0.9 billion) are immediately available and bear variable interest referenced to one month LIBOR.

Independent Auditor's Report on the Review of Interim Consolidated Financial Statements

To the Board of Directors of Roche Holdings, Inc., Wilmington, Delaware

Introduction

We have been engaged to review the accompanying consolidated balance sheet of Roche Holdings, Inc., as at 30 June 2017 and the related consolidated statements of income and comprehensive income, statement of cash flows and statement of changes in equity for the six-month period then ended, and selected explanatory notes (the interim consolidated financial statements) on pages 6 to 26. The Board of Directors is responsible for the preparation and presentation of these interim consolidated financial statements in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the EU. Our responsibility is to express a conclusion on these interim consolidated financial statements based on our review.

Scope of Review

We conducted our review in accordance with the International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim consolidated financial statements as at 30 June 2017 are not prepared, in all material respects, in accordance with International Accounting Standard 34 "Interim Financial Reporting", as adopted by the EU.

KPMG AG

Ian Starkey Licensed Audit Expert	Marc Ziegler Licensed Audit Expert

Basel, 28 July 2017

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