Roche Annual Report 2006

Part 2

Finance Report

We Innovate Healthcare

Innovation spanning the entire healthcare spectrum

Predisposition › Early detection › Prevention › Diagnosis › Therapy › Monitoring

As a pharmaceuticals and a diagnostics company, Roche brings pioneering products and services to market for every stage of the healthcare process, from identifying disease susceptibilities and testing for disease in at-risk populations to prevention, diagnosis, therapy and treatment monitoring.

Our focus on products that deliver significant benefits to patients and health professionals is a core element of our business strategy, and one of the key reasons for our success. As a research-intensive company with a long-term strategic focus, Roche strives to deliver sustainable value to all stakeholders.

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Finance Report 2006

Finance in brief

Key results

		Local sales growth %	Operating profit margin before exceptional items, % of sales
Pharmaceuticals	2006	+21.3	31.7
	2005	+24.8	27.6
Diagnostics	2006	+4.7	16.3
	2005	+4.2	21.5
Group	2006	+17.4	27.9
	2005	+19.3	25.9

	2006 (mCHF)	2005 (mCHF)	% change (CHF)	% change (LC)	% of sales 2006	% of sales 2005
Sales	42,041	35,511	+18	+17		
EBITDA[1)]	14,436	11,568	+25	+24	34.3	32.6
Operating profit before exceptional items	11,730	9,189	+28	+27	27.9	25.9
Profit from continuing businesses before exceptional items	9,151	7,099	+29		21.8	20.0
Net income	9,171	6,866	+34		21.8	19.3
Net cash	16,088	11,215	+43			
Equity	46,814	40,158	+17			
Equity ratio	62.9%	58.0%				
Core EPS[2)] in CHF	9.86	7.84	+26			
Dividend per share[3)] in CHF	3.40	2.50	+36			

1) EBITDA: Earnings before exceptional items and before financial income, financing costs, tax, depreciation and amortisation, including impairment. This corresponds to operating profit before exceptional items and before depreciation and amortisation, including impairment.

2) See page 101 for definition of Core EPS.

3) Proposed by the Board of Directors.

LC = local currencies.

Finance Executive Team

Erich Hunziker	Chief Financial Officer
Hubert Buck	Management Development
Peter Eisenring	Taxes and Insurances
Marco Frei	Pension Asset Management
Andreas Knierzinger	Treasury
Steve Krognes	Corporate Development
Karl Mahler	Investor Relations
Erwin Schneider	Accounting and Controlling

Sales

- Group sales grew by 17% in local currencies to 42.0 billion Swiss francs, driven primarily by the fast organic growth of the Pharmaceuticals Division.
- Pharmaceuticals sales increased by 21% in local currencies or 6.0 billion Swiss francs, strongly outperforming the global market thanks to the key oncology products and also Tamiflu, Bonviva/Boniva and Lucentis. Pharmaceuticals sales now account for 79% of Group sales.
- Oncology product sales grew by 37% in local currencies to 15.3 billion Swiss francs, representing 46% of pharmaceuticals sales.
- Diagnostics sales increased by 5% in local currencies to 8.7 billion Swiss francs, driven primarily by the Centralized Diagnostics business.

Operating results

- Operating profit (before exceptional items) increased by 27% in local currencies to 11.7 billion Swiss francs based on the strong business growth and continuing productivity improvements.
- Record profitability, with operating profit margin (before exceptional items) up by 2.0 percentage points to 27.9%.
- R&D expenditure increased by 16% in local currencies to 6.6 billion Swiss francs, representing 16% of Group sales.
- Significant investment in new biotechnology manufacturing facilities.

Treasury

- Increase in net financial income to 855 million Swiss francs, compared to 328 million Swiss francs in 2005.
- Partial redemption of 'LYONs V' convertible notes and further repayment of bank debt reduces debt by 1.4 billion Swiss francs.

Financial condition

- Increase in net cash to 16.1 billion Swiss francs from 11.2 billion Swiss francs.
- Increase in equity ratio to 63% from 58%.
- Decrease in debt-equity ratio to 18% from 24%.
- Aa1 rating by Moody's and AA+ rating by Standard & Poor's maintained.

Net income

- Increase in overall net income of 34% to 9.2 billion Swiss francs, primarily from the strong operating performance.

Shareholder return

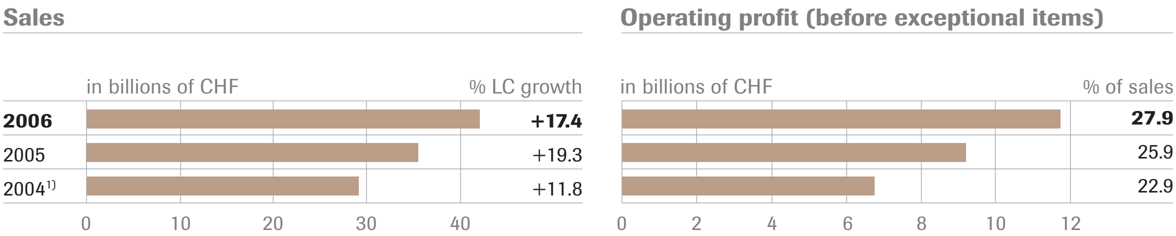
- Market capitalisation increased by 12% to 192 billion Swiss francs. Share price up by 13%, price of non-voting equity security up by 11%.
- Increase in Core EPS of 26% to 9.86 Swiss francs, outpacing Swiss franc sales growth by 8 percentage points.
- Increase in proposed dividend of 36% to 3.40 Swiss francs, representing the 20th consecutive year of dividend growth.

Roche Group

Financial Review

Operating results

Group operating results



1) Continuing businesses.

The 2006 annual results once again show a strong operating performance both in terms of top-line sales growth as well as profit margins, mainly driven by the Pharmaceuticals Division.

Total sales grew by 17% in local currencies (18% in Swiss francs; 18% in US dollars) to 42.0 billion Swiss francs, with the Pharmaceuticals Division contributing 79% of Group sales and the Diagnostics Division representing 21%. The incremental sales increase of 6.5 billion Swiss francs was achieved through organic growth and primarily driven by strong demand for the Group's oncology drugs Herceptin, Avastin, MabThera/Rituxan and Tarceva, by the anti-influenza drug Tamiflu, and by Bonviva/Boniva and Lucentis. This sales increase is after absorbing over 500 million Swiss francs of lower Rocephin sales globally following the product's US patent expiry in July 2005.

The Group's operating profit before exceptional items increased by 27% in local currencies to 11.7 billion Swiss francs and the corresponding operating profit margin grew by 2.0 percentage points to 27.9%. This was driven by an increase in Pharmaceuticals of 4.1 percentage points which more than offset a decline in the margin in Diagnostics of 5.2 percentage points. This overall margin growth was achieved at the same time as the Group continued to increase investments in the strong development pipeline and in launch and pre-launch activities.

The exchange rate impact on sales and operating profit growth as expressed in Swiss francs was moderate, with Swiss-franc growth being 0 to 1 percentage point higher than local-currency growth. In 2006, the average exchange rate for the US dollar was 1% higher and the euro was 2% higher, while the Japanese yen lost 5%.

Group operating results 2006

	Pharmaceuticals (mCHF)	Diagnostics (mCHF)	Corporate (mCHF)	Group (mCHF)
Sales	33,294	8,747	–	42,041
Operating profit before exceptional items	10,545	1,422	(237)	11,730
– margin	31.7	16.3	–	27.9
EBITDA	12,168	2,500	(232)	14,436
– margin	36.5	28.6	–	34.3

Group operating results – Development of results compared to 2005

	Pharmaceuticals	Diagnostics	Corporate	Group
Sales				
– % increase in local currencies	+21	+5	–	+17
Operating profit before exceptional items				
– % increase in local currencies	+40	–21	+96	+27
– margin: percentage point increase	+4.1	–5.2	–	+2.0
EBITDA				
– % increase in local currencies	+34	–5	+99	+24
– margin: percentage point increase	+3.2	–3.1	–	+1.7

Pharmaceuticals operating results

The Pharmaceuticals Division showed a strong sales increase, with growth of 21% in local currencies (22% in Swiss francs; 21% in US dollars) to 33.3 billion Swiss francs, outpacing growth in the global market by a factor of more than three. Operating profit before exceptional items was 10.5 billion Swiss francs, representing a growth of 40% in local currencies. Consequently there was a further margin increase of 4.1 percentage points to 31.7%.

Marketing and distribution costs significantly increased by 17% in local currencies to 8.8 billion Swiss francs reflecting the support for recently launched on-market products and pre-launch activities for global rollouts and new indications. R&D investment in the pipeline continued with 5.9 billion Swiss francs of expenditure, an increase of 19% in local currencies.

Pharmaceuticals Division results

	2006 (mCHF)	2005 (mCHF)	% change (CHF)	% change (local currencies)
Sales	33,294	27,268	+22	+21
Royalties and other operating income	1,277	1,176	+9	+8
Cost of sales	(6,868)	(6,016)	+14	+11
Marketing and distribution	(8,761)	(7,458)	+17	+17
Research and development	(5,889)	(4,970)	+18	+19
General and administration	(1,849)	(1,785)	+4	+3
Amortisation and impairment of intangible assets	(659)	(676)	–3	–3
Operating profit before exceptional items	10,545	7,539	+40	+40
– margin	31.7	27.6	+4.1	
EBITDA	12,168	9,073	+34	+34
– margin	36.5	33.3	+3.2	

Sales: The major growth drivers were the oncology, transplantation and virology franchises (including Tamiflu), with the key oncology franchise again significantly outpacing the market. The renal anemia franchise declined slightly due to biennial selling price cuts and a change in the reimbursement system for Epogin in the Japanese market.

Pharmaceuticals Division – Sales by therapeutic area

Therapeutic area	Sales 2006 (mCHF)	% of sales	% change (local currencies)
Oncology	15,278	46	+37
Inflammation/Autoimmune/Transplantation	2,753	8	+14
Virology	5,443	8[1]/16	–1[1]/+24
Metabolism/Bone	2,228	7	+23
Renal anemia	1,660	5	–3
Others	5,932	18	0
Total	33,294	100	+21

1) Excluding Tamiflu.

The growth and profitability of the Pharmaceuticals Division is primarily due to ten products (Herceptin, Avastin, Tamiflu, MabThera/Rituxan, Lucentis, Tarceva, Bonviva/Boniva, Xeloda, CellCept and Xolair). These represent 59% of the portfolio (2005: 47%; 2004: 37%). Together they grew 50% in 2006, generating over 6.5 billion Swiss francs of additional sales. Overall the Top 20 products grew by 30% and of these only Rocephin was in real decline, due to the US patent expiry in 2005. The decline of 6% for all other products is primarily due to generic erosion affecting Copegus and Roaccutane.

Pharmaceuticals Division – Sales of Top 20 products

	Sales 2006 (mCHF)	% of sales	% change (local currencies)	Therapeutic area
MabThera/Rituxan	4,839	15	+15	Oncology / IAT[1]
Herceptin	3,927	12	+81	Oncology
Avastin	2,962	9	+76	Oncology
Tamiflu	2,627	8	+68	Virology
NeoRecormon/Epogin	2,227	7	–1	Anemia, Oncology
CellCept	1,842	6	+7	IAT[1]
Pegasys	1,467	4	+3	Virology
Xeloda	971	3	+20	Oncology
Tarceva	813	2	+108	Oncology
Xenical	693	2	+7	Metabolism/Bone
Xolair	537	2	+31	Respiratory diseases
Kytril	498	2	0	Oncology
Nutropin	494	2	+3	Metabolism/Bone
Bonviva/Boniva	488	1	+462	Metabolism/Bone
Valcyte/Cymevene	488	1	+22	Virology
Lucentis	478	1	–	Ophthalmology
Pulmozyme	436	1	+10	Respiratory diseases
Rocephin	416	1	–56	Infectious diseases
Neutrogin	379	1	+9	Oncology
Activase/TNKase	362	1	+15	Cardiovascular diseases
Total Top 20 products	26,944	81	+30	
Other products	6,350	19	–6	
Total	33,294	100	+21	

1) Inflammation/Autoimmune/Transplantation

MabThera/Rituxan: Sales growth was driven by higher sales volumes, particularly in Europe and the rest of the world excluding the US and Japan (RoW). This is primarily due to increased usage of MabThera/Rituxan in first-line treatment of indolent and aggressive non-Hodgkin's lymphoma (NHL). In the US, the already high treatment rates for NHL were maintained and price increases in 2005 and 2006 also contributed to sales growth. Initial sales were recorded for the treatment of the new rheumatoid arthritis indication in both US and Europe/RoW which was an additional driver of the overall growth. Further growth potential is also expected from the maintenance indication/treatment immediately following first-line therapy in indolent non-Hodgkin's lymphoma.

Herceptin: Growth of the second highest selling product continued to be driven by increased market share in HER2-positive adjuvant breast cancer (adj. BC) and the launch of this indication in additional countries. Roche estimates that by the end of 2006, Herceptin had around 40% market share in adj. BC in the five key EU markets (France, Germany, Italy, Spain and United Kingdom). Penetration rates in this setting outside these countries are still considerably lower. In the US, growth rates appear to have flattened out due to the earlier and rapid adoption of adjuvant treatment. Also contributing to growth, to a lesser extent, was a price increase effective in 2006.

Avastin: Sales continue to grow strongly, particularly in Europe/RoW where Avastin has now been launched in most markets worldwide in the initial indication for first-line metastatic colorectal cancer (mCRC). In the US, Avastin has already achieved high penetration rates following its launch in early 2004. The continued US growth is primarily driven by the usage of Avastin in first-line advanced non-small cell lung cancer (NSCLC) which was approved by the US Food and Drug Administration (FDA) in combination with chemotherapy in October 2006, and also by unapproved usage in metastatic breast cancer (mBC). There was also growth in 2006 from modest increased usage in first-line mCRC. During 2006 Roche filed for first-line advanced NSCLC in Europe and firstline mBC was filed in both the US and EU. Additional filings to enlarge the European first-line mCRC label to match the broader US label are planned for the first half of 2007. A filing for the treatment of advanced renal cell carcinoma (RCC) in Europe is scheduled for 2007.

Tamiflu: Sales continued to increase mainly due to government pandemic stockpiling which contributed 71% of total sales. There was also an increase in retail sales related to pandemic preparedness. Seasonal sales were lower than last year due to the absence of a severe flu season in the US, Europe and Japan during the calendar year 2006. Significant pandemic orders are still due for delivery during 2007.

NeoRecormon/Epogin: Growth of NeoRecormon was driven by increased usage in both the oncology (+10%) and renal anemia segments (+4%), which offset continued pricing pressure. Epogin sales in Japan declined due to biennial selling price cuts and a change in the reimbursement system. Overall, sales of the anemia franchise also slightly declined.

CellCept: Sales of the leading treatment in the mycophenolic acid (MPA) market were particularly strong in the US, driven by transplant indications and increased usage in the treatment of certain autoimmune indications (currently not approved). Continued sales growth in Western European countries offset the sales decline in some Latin American countries where generic competition commenced.

Pegasys: With 53% market share, Pegasys remains the global market leader in the treatment of hepatitis C (pegylated interferons). Sales were driven by increased use in Europe/RoW, offsetting a decline in the US from an overall decline in market volume. In Japan sales declined due to competition from a combination treatment, however the Pegasys+Copegus combination was approved in this market in January 2007.

Xeloda: The main growth driver was further increased usage of Xeloda for the treatment of both adjuvant colon cancer and mCRC. A filing for gastric cancer was submitted in Europe. Filings to include further combinations on the mCRC label, including use in combination with Avastin, are on track for the first half of 2007.

Tarceva: Sales continued to increase both in the US and in Europe/RoW, which now accounts for close to 40% of overall sales just 14 months after obtaining approval. US sales were driven by approval in the second indication, metastatic pancreatic cancer, as well as pricing increases in 2005 and 2006. In Europe Tarceva was approved for the treatment of advanced pancreatic cancer in January 2007.

Xolair: Sales growth was primarily driven by increased penetration in the asthma market and, to a lesser extent, by pricing increases in 2005 and 2006. Outside the US, Xolair is marketed by Novartis. In the first half of 2007 Genentech expects to complete the acquisition of Tanox, its partner in the development of Xolair.

Bonviva/Boniva: The vast majority of sales come from the US, where Boniva has now captured approximately 15% market share (total prescriptions). Bonviva has been granted reimbursement and was launched in many European markets during 2006.

Lucentis: Following US approval on 30 June 2006, initial sales were driven by high demand among existing age-related macular degeneration (AMD) patients previously on other therapies and use by newly diagnosed patients. Outside the US, Lucentis is marketed by Novartis.

Rocephin: Sales continued to decline rapidly in the US following the patent expiry in July 2005. As US sales are now significantly lower, the marginal effect of the generic competition is now abating.

More information on the products and R&D pipeline can be found on page 27 of the Business Report.

Sales by region: Sales continued to grow in all major regions. In North America, sales grew more than three times above the market, driven by products marketed by Genentech (Avastin, Herceptin, Lucentis, MabThera/Rituxan, Tarceva and Xolair) as well as Tamiflu, Bonviva/Boniva, CellCept, Xeloda and Valcyte/Cymevene. Together these more than compensated for the over 450 million Swiss francs decline in US sales of Rocephin following the US patent expiry in July 2005. In Europe the Group continued to gain market share, driven by continuing strong sales growth of Herceptin, Tamiflu, Avastin, MabThera/Rituxan, Tarceva, Pegasys, Xeloda and NeoRecormon. Sales in Japan declined by 1% due to the biennial government-mandated price cuts effective 1 April 2006. There was growth in Tamiflu sales in Japan, where government pandemic sales more than compensated for lower seasonal flu sales. Sales growth for Herceptin, Neutrogin and Evista was mainly offset by a decline in Epogin sales. These declined due to the biennial price cuts and new rules introducing flat-rate reimbursement for epoetin products used in dialysis patients, which has reduced the size of the anemia market as a whole in Japan.

Pharmaceuticals Division – Sales by regions

Region	Sales 2006 (mCHF)	% of sales	% change (local currencies)
North America	14,064	42	+27
Europe	10,800	32	+22
Japan	3,503	11	–1
Other regions	4,927	15	+24
Total	33,294	100	+21

Royalties and other operating income: The increase of 8% in local currencies was due to higher royalty income and upfront income at Genentech and increased out-licensing income at Roche Pharmaceuticals. Gains on product divestments were not significant at 16 million Swiss francs compared to 55 million Swiss francs in 2005.

Cost of sales: The increase of 11% in local currencies was significantly below the 21% increase in sales. This is due to economies of scale in production and some product mix effects. In addition there are continuing productivity improvements and benefits from concentrating on a smaller number of production sites. These factors more than compensated for the 32% increase in royalty expenses on product sales to 1,714 million Swiss francs from 1,294 million Swiss francs in 2005, driven by the success of MabThera/Rituxan, Tarceva, Xolair and Tamiflu, and for the gross profit share to GlaxoSmithKline from increased Bonviva/Boniva sales.

Marketing and distribution: These costs increased by 17% in local currencies, which is lower than the growth in sales in spite of the continuing intensive support for recent product launches and pre-launch activities for upcoming launches. Significant investments were made in the US for Boniva and Lucentis, in Europe and RoW markets for Avastin and Tarceva, and worldwide for Pegasys and for MabThera/Rituxan in its new indication, rheumatoid arthritis. In addition, there were pre-launch costs in the US for Avastin for NSCLC and breast cancer and for Mircera. In Japan, strategic marketing functions were strengthened and the sales force was significantly increased by reorganising the specialised oncology/renal representatives. Additionally in Japan there was preparation for the much earlier than originally anticipated launches of Avastin and Tarceva and also for the launch of Actemra in rheumatoid arthritis. Furthermore, over the past 12 to 18 months Roche has established a number of new affiliates in Central and Eastern Europe. Costs relating to Tamiflu increased to properly communicate its role in both seasonal flu and pandemic planning. Marketing and distribution costs as a percentage of sales were 26.3% compared to 27.4% in 2005.

Research and development: The increase of over 900 million Swiss francs, or 19% in local currencies, to almost 5.9 billion Swiss francs reflects higher spending on both late-stage clinical trials and early-stage projects. This is driven by the many additional indications, in particular for the oncology portfolio and for MabThera/Rituxan and Actemra in rheumatoid arthritis. Research and development costs as a percentage of sales were 17.7% compared to 18.2% in 2005. In addition Roche spent almost 600 million Swiss francs on the in-licensing of pipeline compounds and technologies, which are capitalised as intangible assets as required by IFRS. In total Roche spent 6.5 billion Swiss francs on internal and purchased R&D from in-licensing and other alliance deals, representing 19.4% of sales and an increase of 22% in local currencies.

General and administration: These costs grew by 3% in local currencies. Favourable developments included lower restructuring costs, in particular at Chugai, and gains made on the disposal of property. Overall these compensated for the costs for a project to harmonise SAP systems across Europe and establish a shared service centre for European affiliates, for higher royalty expenses on royalty income at Genentech and for the creation of new affiliates in Central and Eastern Europe.

Amortisation and impairment of intangible assets: The decline of 3% in local currencies primarily arose from Genentech, as some intangible assets were fully amortised by mid-2005. An impairment charge of 13 million Swiss francs was recorded in the second half of 2006, which relates to the decision to terminate development of one compound with an alliance partner.

Pharmaceuticals sub-divisional results

2006	Sales (mCHF)	EBITDA (mCHF)	EBITDA as % of sales	Operating profit before exceptional items (mCHF)	Operating profit before exceptional items as % of sales
Roche Pharmaceuticals	20,666	7,030	34.0	6,025	29.2
Genentech	9,125	4,413	48.4	3,951	43.3
Chugai	3,503	725	20.7	569	16.2
Pharmaceuticals Division	33,294	12,168	36.5	10,545	31.7
2005					
Roche Pharmaceuticals	16,955	5,577	32.9	4,618	27.2
Genentech	6,614	2,522	38.1	2,124	32.1
Chugai	3,699	974	26.3	797	21.5
Pharmaceuticals Division	27,268	9,073	33.3	7,539	27.6

Within the Pharmaceuticals Division, Roche Pharmaceuticals showed a very strong performance with a sales increase of 20% in local currencies, an increase in operating profit of 29% in local currencies, and an increase in the operating profit margin of 2.0 percentage points to 29.2% of sales. Economies of scale, a favourable product mix development and lower cost ratios in marketing and distribution, research and development and general and administration offset the impact of higher royalty expenses and an increased gross profit share to GlaxoSmithKline following higher Bonviva/Boniva sales. At Genentech, overall costs grew less than the significantly increased sales. Additionally, Genentech received considerably higher royalty income from Roche Pharmaceuticals due to the sales success of Herceptin, Avastin, MabThera/Rituxan and Tarceva. As a consequence the operating profit margin improved by 11.2 percentage points to 43.3%. Chugai reported slightly lower sales in local currencies, mainly as a result of government price cuts. Increased Tamiflu sales from government pandemic planning did not fully offset the impact of these price cuts. Operating profit at Chugai declined by 228 million Swiss francs due to the price cuts and Epogin reimbursement changes mentioned previously and also due to the marketing activities described above. Additional information on the Pharmaceuticals Division's sub-divisional results is given in Note 3 to the Consolidated Financial Statements and further information on Genentech and Chugai is given in Notes 4 and 5.

Diagnostics operating results

The Diagnostics Division increased its sales to 8.7 billion Swiss francs, growing by 5% in local currencies (6% in Swiss francs; 5% in US dollars) while maintaining its leading market position. The operating profit before exceptional items decreased by 21% in local currencies to 1,422 million Swiss francs. Although there was a margin decline of 5.2 percentage points to 16.3%, the cash generation of the business remains well above industry average with an EBITDA of 28.6%. The lower margin was primarily due to further investments in product launches and continued selling price pressure, combined with impairment charges on intangible assets (2.1% of sales) in the second half of 2006. Additionally, 2006 royalty and other operating income was substantially lower, mainly due to the expiry of some PCR-related patents during 2006 and certain one-time income in 2005. Despite the decline in the operating margin in 2006, it remains above the average of the division's major competitors.

Diagnostics Division results

	2006 (mCHF)	2005 (mCHF)	% change (CHF)	% change (local currencies)
Sales	8,747	8,243	+6	+5
Royalties and other operating income	189	271	–30	–31
Cost of sales	(3,748)	(3,254)	+15	+13
Marketing and distribution	(2,095)	(2,049)	+2	+1
Research and development	(700)	(702)	0	–1
General and administration	(456)	(403)	+13	+12
Amortisation and impairment of intangible assets	(515)	(335)	+54	+53
Operating profit before exceptional items	1,422	1,771	–20	–21
– margin	16.3	21.5	–5.2	
EBITDA	2,500	2,611	–4	–5
– margin	28.6	31.7	–3.1	

Sales: The major driver of sales growth was again Centralized Diagnostics (Immunodiagnostics), with Applied Science and Near Patient Testing also delivering solid performances. The continued rollout of products, in particular the rejuvenated Diabetes Care portfolio, combined with the recently launched cobas modular platforms in Centralized Diagnostics, helped strengthen Roche's position in all market segments and led to the increase in growth in the second half of 2006.

Diagnostics Division – Sales by business area

Business area	Sales 2006 (mCHF)	% of sales	% change (local currencies)
Diabetes Care	3,019	35	+3
Centralized Diagnostics	3,100	35	+5
– *of which Immunochemistry*	*1,183*	*14*	*+13*
Molecular Diagnostics	1,211	14	+3
Near Patient Testing	785	9	+7
Applied Science	632	7	+12
Total	8,747	100	+5

Diabetes Care: Diabetes Care maintained its number one position in blood glucose monitoring with sales of 3.0 billion Swiss francs, an increase of 3% in local currencies, following a rebound in growth in the second half of the year. Sales of Accu-Chek blood glucose monitoring meters, strips and lancets increased by 3% in local currencies to 2.8 billion Swiss francs, while insulin delivery sales grew by 11% to 206 million Swiss francs. Global rollout of the new portfolio was completed mid-2006 with the launch of the Accu-Chek Compact Plus in the US and Canada and the Accu-Chek Aviva in Japan. The new Accu-Chek Aviva meter experienced rapid uptake in all markets where launched and reversed the sales decline from the maturation of the Accu-Chek Advantage line. Accu-Chek Compact Plus continues to expand the new ‘integrated’ market segment where it commands a 70% share and remains the only meter on the market integrating measuring, test strip and lancet in one device. In October 2006 the US Food and Drug Administration (FDA) lifted an import alert barring the sale of Accu-Chek insulin pumps in the United States, allowing Roche to immediately re-enter the world’s largest infusion systems market.

Centralized Diagnostics: Sales increased by 5% in local currencies to 3.1 billion Swiss francs, further increasing Roche’s lead in this highly competitive segment. Immunochemistry sales grew significantly above the market rate for the sixth successive year, with a growth of 13% to 1.2 billion Swiss francs. Significant immunochemistry instrument placements in 2005, combined with the increasing demand for the cardiac test Elecsys proBNP, is now resulting in strong reagent sales. Sales in clinical chemistry increased in volume, however the ongoing price pressure in this segment meant that sales declined by 1%, in a flat market. The launch in mid-2006 of the cobas 6000 analyser series, for labs with medium workloads, was the first in a series of the modular platform designed to integrate and improve the efficiency of clinical chemistry and immunochemistry testing in different sized laboratories, and will strengthen our product offering in this important market segment.

Molecular Diagnostics: Molecular Diagnostics remained the clear market leader with sales of 1.2 billion Swiss francs and growth of 3% in local currencies. Sales in virology grew by 5% in local currencies to 559 million Swiss francs in a flat market, supported by the new automated platforms which helped combat pricing pressure in this highly competitive segment. Blood screening showed evidence of slowing growth (sales 310 million Swiss francs, a decrease of 1% in local currencies) with an increase in the number of centres coming online offset by a price reduction in Japan earlier in the year. In June 2006 Roche began rolling out across Europe the new fully automated cobas s 201 modular blood screening system and cobas TaqScreen MPX multiplex test, which simultaneously detects HIV, HCV and HBV in donated blood or plasma. Roche is on track to submit filings to the FDA in the first half of 2007 for tests to detect and genotype low and high-risk types of human papillomavirus (HPV).

Near Patient Testing: Sales rose 7% to 785 million Swiss francs, helped by improved marketing of the business area’s broad portfolio and by the continued move towards decentralised testing. Coagulation sales increased by 6% in local currencies to 196 million Swiss francs, due to the growing trend towards patient self-monitoring. The new coagulation monitoring systems, CoaguChek XS for patient self-monitoring and CoaguChek XS Plus for healthcare professionals, commenced their European rollout in January and October, respectively, and a full US launch of the CoaguChek XS for professional use is planned for the first quarter of 2007.

Applied Science: In a highly fragmented and competitive life science market, Applied Science grew at 12% to 632 million Swiss francs, this being twice the market rate. The major contributors were sales of the Genome Sequencer 20 system (for DNA sequencing), the LightCycler 480 system (for high-throughput real-time PCR) and the industrial business (reagents for industrial processes).

Sales by regions: Sales continued to grow ahead of the local market in all regions with the exception of North America. North America returned to positive growth in the second half of 2006, helped by Immunochemistry and the rebound in Diabetes Care. Sales growth in Japan was particularly strong given the across-the-board price cut of 10% in April.

Diagnostics Division – Sales by regions

Region	Sales 2006 (mCHF)	% of sales	% change (local currencies)
North America	2,455	28	+2
EMEA[1]	4,190	48	+5
Japan	426	5	+3
Other regions	1,676	19	+8
Total	8,747	100	+5

1) Europe, Middle East and Africa (excluding Iberia).

Royalties and other operating income: At 189 million Swiss francs, royalty and other operating income was 31% in local currencies or 82 million Swiss francs lower than in the comparative period which included substantial one-off income from out-licensing agreements. Royalty income in 2006 was lower due to the expiry in March 2006 of the foundational PCR patents in most countries outside the US. In the US, the patents expired in March 2005.

Cost of sales: The overall increase of 13% in local currencies was considerably higher than sales growth. This was a result of business area mix and product mix impacts and higher depreciation resulting from the significantly increased leased-out instruments base. Royalty expenses of 263 million Swiss francs in 2006 were 10% higher in local currencies primarily due to Centralized Diagnostics. Cost of sales as a percentage of sales increased to 42.8% from 39.5% in 2005.

Marketing and distribution: These costs remained stable at the 2005 level with increased overall investment in 2006 offset by the significant launch expenses for a number of new Diabetes Care products in the 2005 comparative numbers. In addition, sample consumption and inventory write-offs were lower in 2006, and some global functions across the division and business areas were streamlined. Marketing and distribution as a percentage of sales declined to 24.0% from 24.9% in 2005.

Research and development: Costs decreased slightly by 1% in local currencies. The decline reflects changes in the timing of projects and lower expenses from third-party collaborations. As a percentage of sales, research and development costs declined to 8.0% from 8.5% in 2005.

General and administration: These costs increased by 12% in local currencies, mainly due to increased accruals for prior year royalties following from ongoing discussions with various contract partners. In addition there were restructuring expenses of 17 million Swiss francs.

Amortisation and impairment of intangible assets: The increase is due to impairment charges of 184 million Swiss francs recorded in the second half of 2006, following updating of the division's business plans and technology assessments. These charges mainly relate to intangible assets recorded from the Disetronic acquisition in 2003.

Corporate operating costs

General and administration: Costs increased to 237 million Swiss francs (121 million Swiss francs in 2005), which is explained by the inclusion in the 2005 results of a gain of 127 million Swiss francs from the settlement of pension plans at Chugai. Excluding this, corporate operating costs declined by 4%.

Exceptional operating items

Major legal cases: There were no income statement impacts from developments in major legal cases in 2006. Additional information on major legal cases is given in Note 7 to the Consolidated Financial Statements.

Total operating results

	Pharmaceuticals 2006 (mCHF)	2005 (mCHF)	Diagnostics 2006 (mCHF)	2005 (mCHF)	Corporate 2006 (mCHF)	2005 (mCHF)	Group 2006 (mCHF)	2005 (mCHF)
Operating profit before exceptional items	10,545	7,539	1,422	1,771	(237)	(121)	11,730	9,189
Major legal cases	–	(210)	–	(146)	–	–	–	(356)
Operating profit	10,545	7,329	1,422	1,625	(237)	(121)	11,730	8,833

Operating profit: The increase of 2,897 million Swiss francs or 33% in local currencies reflects the strong business expansion, the continued improvement in the Group's operating performance and the inclusion of exceptional items for major legal cases in the comparative 2005 results.

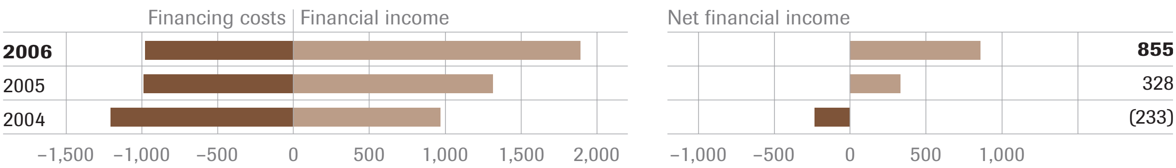
Non-operating results

During 2006 the Group's treasury operations and pension management delivered a positive net financial income, with net income from financial assets and foreign exchange management exceeding financing costs by 855 million Swiss francs. The Group's effective tax rate increased by 2.4 percentage points to 27.3% from 24.9%, mainly due to an increase in the effective tax rate at Genentech. Profit from continuing businesses and net income increased due to the combination of positive developments on the operating and financial lines and the absence of major legal case expenses in 2006, which more than compensated for the increase in the effective tax rate.

Non-operating results

	2006 (mCHF)	2005 (mCHF)	% change (CHF)
Operating profit	11,730	8,833	+33
Associated companies	2	1	+100
Financial income	1,829	1,313	+39
Financing costs	(974)	(985)	–1
Profit before taxes	12,587	9,162	+37
Income taxes	(3,436)	(2,284)	+50
Profit from continuing businesses	9,151	6,878	+33
Profit from discontinued businesses	20	(12)	–
Net income	9,171	6,866	+34
Attributable to			
– Roche shareholders	7,880	5,923	+33
– Minority interests	1,291	943	+37

Net financial income *in millions of CHF*

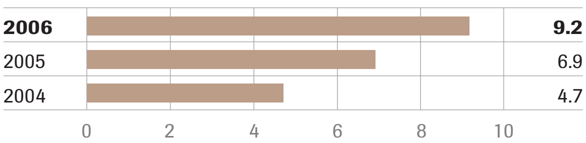


Financial income: Financial income showed a strong increase compared to 2005. Net income from equity securities was 390 million Swiss francs compared to 258 million Swiss francs in 2005, driven by strongly performing equity markets during 2006 and the disposal of some equity investments. Interest income and income from debt securities almost doubled to 780 million Swiss francs due to higher holdings and increases in interest rates. Expected returns on pension plan assets were 636 million Swiss francs, in line with 2005. Net foreign exchange losses were 24 million Swiss francs compared to losses of 34 million Swiss francs in 2005. A full analysis of financial income is given in Note 8 to the Consolidated Financial Statements.

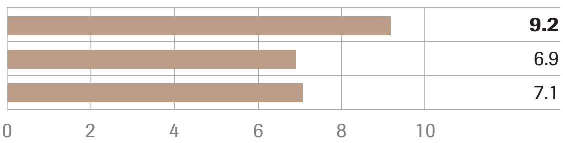
Financing costs: Financing costs were 974 million Swiss francs and declined by 1% compared to 2005. Interest expenses increased as a result of the 2 billion US dollar Senior Notes issued at Genentech in mid-2005. This was only partly compensated by lower interest expenses resulting from the partial conversion of 'LYONs V' notes and some bank debt redemption. As most debt instruments are fixed, increasing interest rates did not have a major impact on financing costs. Interest costs of defined benefit plans were 571 million Swiss francs, slightly lower than 2005. A full analysis of financing costs is given in Note 8 to the Consolidated Financial Statements.

Income taxes: The Group's effective tax rate was 27.3% compared to the 2005 rate of 24.9%. The main influence was the increase in the effective tax rate at Genentech (to 42% from 36%). As in the 2006 interim results, the accounting for equity compensation plans adversely affected the effective tax rate at Genentech, as the development of the Genentech share price in 2006 meant that only a small accounting tax benefit was recorded from the expensing of equity compensation plans. In addition the 2005 tax charge at Genentech includes certain tax credits. Excluding Genentech and Chugai, the underlying effective tax rate of 18.9% is slightly lower than the 2005 rate of 20.2%. An analysis of the effective tax rate is given in Note 9 to the Consolidated Financial Statements.

Profit from continuing businesses *in billions of CHF*



Net income *in billions of CHF*



Profit from continuing businesses: The increase of 33% compared to 2005 is due to the positive developments in the operating and financial lines. Excluding the 2005 exceptional item major legal cases, profit from continuing businesses increased by 2.1 billion Swiss francs or 29%.

Discontinued businesses: There were no significant results from discontinued operations, with 2006 showing a small release of provisions that are no longer required. The comparative results include the operating results for the remaining 2% of the Consumer Health (OTC) business that was transferred to Bayer in 2005. Further information about discontinued businesses is given in Note 11 to the Consolidated Financial Statements.

Net income: In 2006 Group net income increased by 34% to 9.2 billion Swiss francs and the return on sales margin was 21.8%. Net income attributable to the Roche shareholders was 33% higher than in the comparative period. The share of net income attributable to minorities increased by 37% to 1,291 million Swiss francs due to the continually improving profit contribution by Genentech. Within this, 1,077 million Swiss francs are attributable to Genentech minority interests and 202 million Swiss francs to Chugai minority interests.

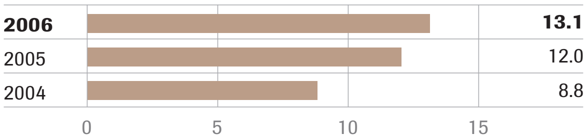
Diluted EPS

	2006 (CHF)	2005 (CHF)	% change
Group	9.05	6.87	+32
Core	9.86	7.84	+26

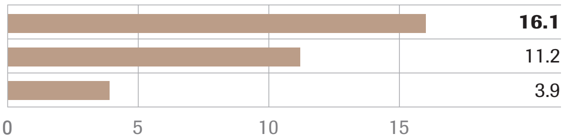
The increase in diluted EPS was due to the higher net income in 2006. The Core EPS, which excludes exceptional items and also amortisation and impairment of intangible assets, increased by 26% to 9.86 Swiss francs from 7.84 Swiss francs. This shows the underlying improvements in the Group's operating and financial results. Supplementary net income and EPS information is given on page 101. This includes calculations of profit from continuing businesses before exceptional items and Core EPS and reconciles these to the Group's published IFRS results.

Cash flows and net cash

Cash flows from operating activities (before income taxes) *in billions of CHF*



Net cash
in billions of CHF



Condensed cash flow statement

	2006 (mCHF)	2005 (mCHF)
Cash generated from operations	15,975	12,521
(Increase) decrease in working capital	(1,897)	488
Costs of major legal cases paid	(31)	(180)
Other operating cash flows	(921)	(857)
Operating activities before income taxes	13,126	11,972
Income taxes paid (all activities)	(2,797)	(1,997)
Operating activities	10,329	9,975
Investing activities	(7,450)	(5,686)
Financing activities	(3,715)	(2,781)
Net effect of currency translation on cash	(182)	115
Increase (decrease) in cash	(1,018)	1,623

A full consolidated cash flow statement is given on page 25 of the Consolidated Financial Statements.

Operating cash flows: The Group's business operations continued to show strong cash generation of 16.0 billion Swiss francs, driven by continued growth in EBITDA. The development of the business led to an increase in working capital, mainly in inventories and trade receivables. In particular there were increases at Genentech and from the growth in the business in Central and Eastern Europe. Income tax payments increased due to payments made by Genentech and Chugai. In total, operating cash flows after taxes increased by 4% to 10.3 billion Swiss francs.

Investing cash flows: The largest investing cash flows in 2006 are for expenditure on property, plant and equipment of 3.6 billion Swiss francs, particularly for biotechnology manufacturing facilities, and a net reinvestment of cash into marketable securities of 4.5 billion Swiss francs. The comparative 2005 cash flows include the receipt from Bayer of 2.9 billion Swiss francs proceeds from the divestment of the Consumer Health (OTC) business and the 0.5 billion Swiss francs used by Genentech to purchase the Oceanside biologics manufacturing facility.

Financing cash flows: Significant financing cash flows in 2006 and 2005 relate to dividend payments and the redemption of debt instruments. Dividends paid by Roche in 2006 were 2.2 billion Swiss francs (2005: 1.7 billion Swiss francs) and cash used for the redemption of debt instruments was 1.3 billion Swiss francs (used to purchase equity instruments to cover partial conversion of the 'LYONs V' notes) compared to 1.2 billion Swiss francs in 2005 (used for the 'Sumo' bonds). Following the partial conversion of the 'LYONs V' notes the Group reduced its own equity instruments holdings in 2006, realising a cash inflow of 1.4 billion Swiss francs. In 2005 Genentech issued 2 billion US dollars of Senior Notes resulting in a cash inflow equivalent to 2.6 billion Swiss francs. In 2006 Genentech received 0.5 billion Swiss francs from stock option exercises (2005: 1.0 billion Swiss francs) in 2006 and repurchased shares for 1.2 billion Swiss francs (2005: 2.5 billion Swiss francs).

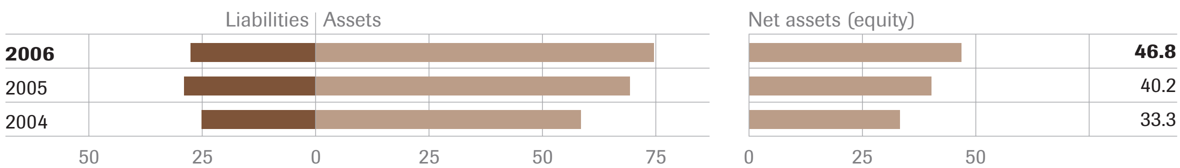
Net cash

	31 December 2006 (mCHF)	31 December 2005 (mCHF)	% change
Cash and cash equivalents	3,210	4,228	–24
Marketable securities	21,121	16,657	+27
Long-term debt	(6,199)	(9,322)	–34
Short-term debt	(2,044)	(348)	+487
Net cash	16,088	11,215	+43

Net cash further increased during 2006 to 16.1 billion Swiss francs. The main drivers were the strong cash inflow from operating activities of 10.3 billion Swiss francs, expenditures for property, plant and equipment, and the Roche dividend payment. The increase in short-term debt is due to the reclassification of the 'LYONs V' notes and US dollar European Medium Term Notes from long-term to short-term debt.

Balance sheet

Balance sheet *in billions of CHF*



Condensed balance sheet

	31 December 2006 (mCHF)	31 December 2005 (mCHF)	% change
Property, plant and equipment	16,417	15,097	+9
Goodwill and intangible assets	11,383	12,388	–8
Other non-current assets	5,719	6,084	–6
Cash and marketable securities	24,331	20,885	+16
Other current assets	16,564	14,741	+12
Total assets	74,414	69,195	+8
Debt (current and non-current)	(8,243)	(9,670)	–15
Other non-current liabilities	(8,709)	(10,223)	–15
Other current liabilities	(10,648)	(9,144)	+16
Total liabilities	(27,600)	(29,037)	–5
Total net assets	46,814	40,158	+17
Capital and reserves attributable to Roche shareholders	39,444	33,334	+18
Equity attributable to minority interests	7,370	6,824	+8
Total equity	46,814	40,158	+17

A full consolidated balance sheet is given on page 24 of the Consolidated Financial Statements.

Non-current assets: The decrease in the US dollar to 1.22 against the Swiss franc at 31 December 2006 from 1.31 at 31 December 2005 decreased long-term assets in Swiss franc terms since many of the Group's production facilities and intangible assets are denominated in US dollars. This was offset by capital expenditure of 4.5 billion Swiss francs.

Current assets: Inventories and accounts receivable were higher in local currencies following from the growth of the business. The total balance of cash and marketable securities increased by 3.4 billion Swiss francs as a result of the Group's strong cash generation.

Debt: The partial conversion of the 'LYONs V' notes and the further repayment of bank loans reduced debt by 1.4 billion Swiss francs. The remaining 0.6 billion Swiss francs carrying value of the 'LYONs V' notes is now classified as short-term debt, due to the Group's option to redeem the notes from 25 July 2007 onwards. Additionally the movement in the US dollar exchange rate decreased the Swiss franc carrying value of the Group's US dollar-denominated debt instruments.

Other non-current and current liabilities: There were no significant movements in the overall balance in local currencies, with most of the movement being due to currency translation or transfers between current and non-current liabilities.

Total net assets/equity: The most significant movements were the net income of 9.2 billion Swiss francs, the Roche dividend payments of 2.2 billion Swiss francs and currency translation losses of 1.5 billion Swiss francs. The currency translation losses mainly arose from the decrease in the US dollar relative to the Swiss franc, which particularly affects the balance sheet values of assets and liabilities that have concentrations in the US, such as property, plant and equipment, goodwill and other intangible assets and debt.

Strong financial condition: The Group remains solidly financed, with equity (including minority interests) representing 63% of total assets and 83% of total assets financed long-term.

Pensions and other post-employment benefits

Post-employment benefit plans are classified as 'defined contribution plans' if the 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. In 2006 expenses for the Group's defined contribution plans were 214 million Swiss francs (2005: 174 million Swiss francs), the increase arising mainly from Genentech. All other plans are classified as 'defined benefit plans', even if the Group's potential obligation is relatively minor or has a relatively remote possibility of arising. The funding and asset management of the Group's various defined benefit plans is overseen at a corporate level. Plans are usually established as trusts independent of the Group and are funded by payments from the Group and by employees, but in some cases the plan is unfunded and the Group pays pensions to retired employees directly from its own financial resources.

Funding status of defined benefit pension and other post-employment benefit plans

	2006 (mCHF)	2005 (mCHF)
Funded plans		
– Fair value of plan assets	11,632	10,858
– Defined benefit obligation	(11,002)	(10,976)
– Over (under) funding	630	(118)
Unfunded plans		
– Defined benefit obligation	(3,596)	(3,630)

Funding status: Overall the Group's defined benefit plans continue to be adequately funded, with the main movements arising from better than expected returns on plan assets and currency translation effects from plans denominated in US dollars and euros. The funding status increased to 106% from 99%. An increase in the discount rates used in the 2006 valuations of Eurozone plans reduced the defined benefit obligations slightly.

Expenses recorded in income statement: Pension expenses in 2006 relating to the Group's defined benefit plans were 283 million Swiss francs, more than double the 2005 expenses of 117 million Swiss francs. This is mainly due to the one-time settlement gain in 2005 of 127 million Swiss francs that arose when Chugai returned part of its employees' pension fund to the Japanese government. Excluding this, pension costs in 2006 increased by 16% mainly due to changes in discount rates adopted at the end of 2005. The revised actuarial assumptions included in the actuarial valuations at the end of 2006 are expected to lead to further increases in 2007, which partly arise from increased life expectancy.

Full details of the Group's pensions and other post-employment benefits are given in Note 13 to the Consolidated Financial Statements.

Roche securities

Price development

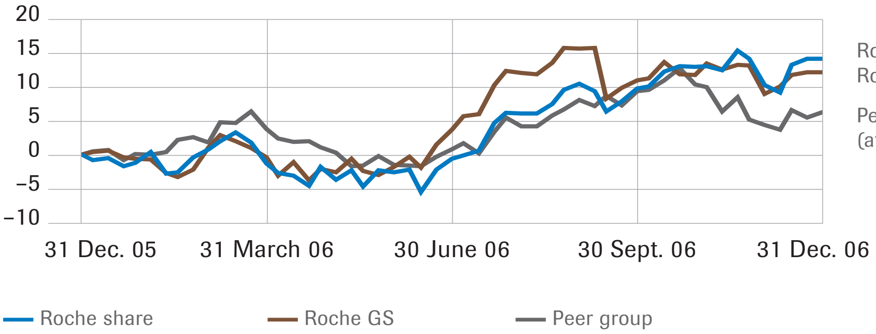
The Roche securities outperformed again a peer group of 17 healthcare companies[1] but rose slightly less than the Swiss market.

Share price and market capitalisation (at 31 December)

	2006	2005	% change
Share price (CHF)	247.50	219.20	+13
Non-voting equity security *(Genussschein)* price (CHF)	218.50	197.30	+11
Market capitalisation (CHF billions)	192	171	+12

Roche ranked number 5 among its peers, as listed below, in terms of Total Shareholder Return (TSR), i.e. share price growth plus dividends, in 2006 when measured in Swiss francs. Year-end return was 14% for the Roche share and 12% for the Roche non-voting equity security. The combined performance of share and non-voting equity security was 13% compared to a weighted average return for Roche and the peer group of 6% at actual exchange rates.

Total Shareholder Return development *in %*



	Price	TSR
Roche share	247.50	14%
Roche GS	218.50	12%
Peer group (at actual exchange rates)		6%

Dividend

The Board of Directors is proposing a 36% increase in the dividend for 2006 to 3.40 Swiss francs per share and non-voting equity security (2005: 2.50 Swiss francs) for approval at the Annual General Meeting. This is the 20th consecutive increase in the dividend. If the dividend proposal is approved by shareholders, dividend payments on the shares and non-voting equity securities in issue will amount to 2.9 billion Swiss francs (2005: 2.2 billion Swiss francs), resulting in a payout ratio of 38% (2005: 36%). Based on the prices at year-end 2006, the dividend yield on the Roche share is 1.4% (2005: 1.1%) and the yield on the non-voting equity security is 1.6% (2005: 1.3%). Further information on the Roche securities is given on page 103 of the Finance Report.

1) Peer group for 2006: Abbott Laboratories, Amgen, AstraZeneca, Bayer, Becton Dickinson, Biogen Idec, Bristol-Myers Squibb, Eli Lilly, GlaxoSmithKline, Johnson & Johnson, Merck, Novartis, Pfizer, Sanofi-Aventis, Schering-Plough, Takeda, Wyeth.

Information per share and non-voting equity security

Information per share and non-voting equity security

	2006 (CHF)	2005 (CHF)	% change
Basic EPS	9.24	7.01	+32
Diluted EPS	9.05	6.87	+32
Core EPS	9.86	7.84	+26
Equity attributable to Roche shareholders per share	45.73	38.65	+18
Dividend per share	3.40	2.50	+36

For further details please refer to Notes 31 and 32 of the Consolidated Financial Statements and page 101 of the Finance Report.

Financial risks

Value-at-Risk and Earnings-at-Risk analysis tools

The Value-at-Risk (VaR) calculations are used to indicate the ranges within which the value of the respective assets or liabilities may fluctuate with a certain probability over a certain time period (holding period). The VaR measure is a statistical measure, implicitly assuming that the value changes of the recent past are indicative of value changes in the future. Market shocks are included in this calculation to the extent that they occurred in the observation period. The Group uses statistically relevant observation periods and applies holding periods, which reflect the time period required to change the respective risk exposure if deemed appropriate. With longer holding periods, the probability of higher value changes increases and so does the VaR measure.

Earnings-at-Risk (EaR) is equivalent to the VaR methodology, but rather than potential value changes, it indicates the potential changes to profits (losses) with a certain probability and over a certain time period. The same constraints and limitations apply to this methodology.

All VaR and EaR figures for interest rate risks are measured using a historical simulation approach. For each historical scenario (representing all price and rate changes of all individual instruments over a specific 20-day period in the past 10 years), all financial instruments are fully revalued (using valuation models) and the total change in value and earnings is determined. All VaR and EaR calculations below are based on a 95% confidence level and a holding period of 20 trading days.

The Group cannot predict future market movements. The VaR and EaR figures given below do not represent the actual losses which are expected or might be incurred on financial assets and liabilities, nor the possible worst loss over the period stated, nor do they consider the effect of favourable changes in market rates.

Foreign exchange risk

The Group's exposure to movements in foreign currencies affecting its net income and financial position, as expressed in Swiss francs, is summarised by the following key figures and comments.

Growth (continuing businesses)

	% change (local currencies)		% change (CHF)	
	2006	2005	2006	2005
Sales	+17	+19	+18	+20
Operating profit before exceptional items	+27	+33	+28	+33

Exchange rates against the Swiss franc

	31 December 2006	Average 2006	31 December 2005	Average 2005
1 USD	1.22	1.25	1.31	1.25
1 EUR	1.61	1.57	1.56	1.55
1 GBP	2.40	2.31	2.27	2.26
100 JPY	1.03	1.08	1.12	1.13

On average in 2006 the US dollar and the euro slightly strengthened against the Swiss franc compensating for the weaker yen. Consequently there is almost no difference between sales growth and operating profit growth expressed in Swiss francs or in local currencies. In absolute terms, the sensitivity of Group sales of continuing businesses to a movement in the US dollar against the Swiss franc of 0.01 Swiss francs during 2006 was approximately 130 million Swiss francs, and the corresponding sensitivities for the euro and yen were approximately 70 million Swiss francs and 35 million Swiss francs respectively.

In 2006 the Group further pursued a strategy to continuously lock in favourable developments of foreign exchange rates by entering into derivative contracts. Due to increased hedging activities associated with the strong sales growth of the Group, the foreign exchange transaction VaR increased compared to a very low exposure at year end 2005. In absolute terms it still remained at a low level.

Foreign exchange risks

	31 December 2006 (mCHF)	31 December 2005 (mCHF)	% change
VaR of monetary positions	20	9	+122

Interest rate risk

Interest rate risk arises from movements in interest rates which could have adverse effects on the Group's net income or financial position. Changes in interest rates cause variations in interest income and expenses on interest-bearing assets and liabilities. In addition, they can affect the market value of certain financial assets, liabilities and instruments. Where appropriate, the Group uses financial derivatives such as swaps to manage its interest rate risk.

During 2006 the Group unwound most of its fair value hedges on its fixed-rate capital market debt, leading to an increased interest rate VaR. The effect was partly compensated by a debt reduction of 1.4 billion Swiss francs due to the redemption of outstanding bank debt and partial conversion of LYONs V convertible notes. The effect of higher liquid funds on interest rate VaR was small, as most instruments have a short duration.

The comparatively small risks from re-pricing or re-financing were contained at reasonable levels. However Earnings-at-Risk (EaR) has increased mainly as a result of more liquid funds held with short interest rate commitments and because of the generally higher interest rate levels, which allow more room for downward changes in interest rates.

Interest rate risks

	31 December 2006 (mCHF)	31 December 2005 (mCHF)	% change
VaR of instruments sensitive to interest rates	29	23	+26
EaR of instruments sensitive to interest rates	39	26	+50

Market risk of financial assets and liabilities

Changes in the market value of financial assets and liabilities can affect the net income or financial position of the Group. Market risk arises from movements in stock prices, interest rates or foreign exchange rates.

The Group's financial assets are mostly held in highly liquid bonds and money market instruments. The equity allocation in the Group's portfolio of cash and marketable securities is 0.9 billion Swiss francs, or 4% of total cash and marketable securities. This figure remained stable compared to 2005 (0.8 billion Swiss francs, or 4% of total cash and marketable securities).

International Financial Reporting Standards

The Roche Group has been using International Financial Reporting Standards (IFRS) to report its consolidated results since 1990. The International Accounting Standards Board (IASB) has published a number of new and revised standards and interpretations that first became effective in 2006, which the Group implemented from 1 January 2006. The only significant changes that relate to the Roche Group financial statements arise from IAS 19 (revised) 'Employee benefits', in particular with respect to defined benefit pension and other post-employment benefits. These changes have been implemented effective 1 January 2006 and the comparative 2005 results have been restated for these changes from those previously published.

Defined benefit plans – Actuarial gains and losses: All actuarial gains and losses are now recognised immediately and recorded directly to equity. Previously actuarial gains and losses below a certain threshold were not recognised and those above this threshold were only recognised progressively. As a result of this change the Group's consolidated balance sheet more accurately represents the funding status of the various plans.

Defined benefit plans – Expected return on plan assets and interest cost: The Group now reports the expected return on plan assets and interest costs from defined benefit plans as part of financial income and financing costs, respectively. Previously these were reported as part of the divisional operating results. This change in presentation aligns the reporting of the Group's results more closely with its internal management and organisation structure.

Full details of the changes are given in Note 1 to the Consolidated Financial Statements. Supplementary presentation materials from the investor update held on 7 June 2006 are available on the 'Investor Relations' section of the Group's website at www.roche.com.

Roche Group Consolidated Financial Statements

Reference numbers indicate corresponding Notes to the Consolidated Financial Statements.

Consolidated income statement for the year ended 31 December 2006 *in millions of CHF*

	Pharmaceuticals	Diagnostics	Corporate	Group
Sales[3]	33,294	8,747	–	42,041
Royalties and other operating income[6]	1,277	189	–	1,466
Cost of sales	(6,868)	(3,748)	–	(10,616)
Marketing and distribution	(8,761)	(2,095)	–	(10,856)
Research and development[3]	(5,889)	(700)	–	(6,589)
General and administration	(1,849)	(456)	(237)	(2,542)
Amortisation and impairment of intangible assets[3]	(659)	(515)	–	(1,174)
Operating profit before exceptional items[3]	10,545	1,422	(237)	11,730
Major legal cases[7]	–	–	–	–
Operating profit[3]	10,545	1,422	(237)	11,730
Associated companies[18]				2
Financial income[8]				1,829
Financing costs[8]				(974)
Profit before taxes				12,587
Income taxes[9]				(3,436)
Profit from continuing businesses				9,151
Profit from discontinued businesses[11]				20
Net income				9,171
Attributable to				
– Roche shareholders				7,880
– Minority interests				1,291

Earnings per share and non-voting equity security[32]	Continuing businesses	Group
Basic (CHF)	9.22	9.24
Diluted (CHF)	9.03	9.05

Consolidated income statement for the year ended 31 December 2005 *in millions of CHF*

	Pharmaceuticals	Diagnostics	Corporate	Group
Sales[3]	27,268	8,243	–	35,511
Royalties and other operating income[6]	1,176	271	–	1,447
Cost of sales	(6,016)	(3,254)	–	(9,270)
Marketing and distribution	(7,458)	(2,049)	–	(9,507)
Research and development[3]	(4,970)	(702)	–	(5,672)
General and administration	(1,785)	(403)	(121)	(2,309)
Amortisation and impairment of intangible assets[3]	(676)	(335)	–	(1,011)
Operating profit before exceptional items[3]	7,539	1,771	(121)	9,189
Major legal cases[7]	(210)	(146)	–	(356)
Operating profit[3]	7,329	1,625	(121)	8,833
Associated companies[18]				1
Financial income[8]				1,313
Financing costs[8]				(985)
Profit before taxes				9,162
Income taxes[9]				(2,284)
Profit from continuing businesses				6,878
Profit from discontinued businesses[11]				(12)
Net income				6,866
Attributable to				
– Roche shareholders				5,923
– Minority interests				943

Earnings per share and non-voting equity security[32]	Continuing businesses	Group
Basic (CHF)	7.02	7.01
Diluted (CHF)	6.89	6.87

As disclosed in Note 1, the income statement for 2005 has been restated following the changes in IFRS that were adopted effective 1 January 2006. A reconciliation to the previously published income statement is provided in Note 1.

Consolidated balance sheet *in millions of CHF*

	31 December 2006	31 December 2005
Non-current assets		
Property, plant and equipment[15]	16,417	15,097
Goodwill[16]	5,914	6,132
Intangible assets[17]	5,469	6,256
Associated companies[18]	7	58
Financial long-term assets[19]	2,152	2,190
Other long-term assets[19]	794	660
Deferred income tax assets[9]	1,935	2,551
Post-employment benefit assets[13]	831	625
Total non-current assets	33,519	33,569
Current assets		
Inventories[20]	5,592	5,041
Accounts receivable[21]	8,960	7,698
Current income tax assets[9]	258	299
Other current assets[22]	1,754	1,703
Marketable securities[23]	21,121	16,657
Cash and cash equivalents[24]	3,210	4,228
Total current assets	40,895	35,626
Total assets	74,414	69,195
Non-current liabilities		
Long-term debt[30]	(6,199)	(9,322)
Deferred income tax liabilities[9]	(2,310)	(3,462)
Post-employment benefit liabilities[13]	(4,221)	(4,408)
Provisions[28]	(1,593)	(1,547)
Other non-current liabilities[29]	(585)	(806)
Total non-current liabilities	(14,908)	(19,545)
Current liabilities		
Short-term debt[30]	(2,044)	(348)
Current income tax liabilities[9]	(2,034)	(811)
Provisions[28]	(756)	(833)
Accounts payable[25]	(2,213)	(2,373)
Accrued and other current liabilities[26]	(5,645)	(5,127)
Total current liabilities	(12,692)	(9,492)
Total liabilities	(27,600)	(29,037)
Total net assets	46,814	40,158
Equity		
Capital and reserves attributable to Roche shareholders[31]	39,444	33,334
Equity attributable to minority interests[33]	7,370	6,824
Total equity	46,814	40,158

As disclosed in Note 1, the balance sheet for 2005 has been restated following the changes in IFRS that were adopted effective 1 January 2006. A reconciliation to the previously published balance sheet is provided in Note 1.

Consolidated cash flow statement *in millions of CHF*

	Year ended 31 December 2006	2005
Cash flows from operating activities		
Cash generated from operations[35]	15,975	12,521
(Increase) decrease in working capital	(1,897)	488
Major legal cases[7]	(31)	(180)
Payments made for defined benefit post-employment plans[13]	(323)	(303)
Utilisation of restructuring provisions[28]	(98)	(119)
Utilisation of other provisions[28]	(344)	(310)
Other operating cash flows	(156)	(125)
Cash flows from operating activities, before income taxes paid	13,126	11,972
Income taxes paid	(2,797)	(1,997)
Total cash flows from operating activities	10,329	9,975
Cash flows from investing activities		
Purchase of property, plant and equipment	(3,561)	(3,319)
Purchase of intangible assets	(593)	(349)
Disposal of property, plant and equipment	330	353
Disposal of intangible assets	1	2
Disposal of products[6]	15	56
Business combinations[10]	–	(233)
Divestments of discontinued businesses[11]	(5)	2,902
Other divestments of subsidiaries[4]	14	–
Interest and dividends received[35]	846	383
Sales of marketable securities	5,236	9,859
Purchases of marketable securities	(9,689)	(15,190)
Other investing cash flows	(44)	(150)
Total cash flows from investing activities	(7,450)	(5,686)
Cash flows from financing activities		
Proceeds from issue of long-term debt instruments[30]	–	2,565
Repayment and redemption of long-term debt instruments[30]	(1,264)	(1,178)
Increase (decrease) in other long-term debt	(638)	(1,083)
Transactions in own equity instruments[31]	1,367	779
Increase (decrease) in short-term borrowings	200	(422)
Interest and dividends paid[35]	(2,600)	(1,983)
Exercises of equity-settled equity compensation plans[14]	480	1,090
Genentech share repurchases[4]	(1,248)	(2,511)
Other financing cash flows	(12)	(38)
Total cash flows from financing activities	(3,715)	(2,781)
Net effect of currency translation on cash and cash equivalents	(182)	115
Increase (decrease) in cash and cash equivalents	(1,018)	1,623
Cash and cash equivalents at 1 January	4,228	2,605
Cash and cash equivalents at 31 December[24]	3,210	4,228

Consolidated statement of recognised income and expense *in millions of CHF*

	Year ended 31 December 2006	2005
Available-for-sale investments		
– Valuation gains (losses) taken to equity[31]	292	(77)
– Transferred to income statement on sale or impairment[31]	(184)	(73)
Cash flow hedges		
– Gains (losses) taken to equity[31]	(71)	178
– Transferred to income statement[31]	–	–
– Transferred to the initial balance sheet carrying value of hedged items[31]	–	–
Exchange differences on translation of foreign operations[31]	(1,487)	2,376
Defined benefit post-employment plans		
– Actuarial gains (losses)[31]	761	(552)
– Limit on asset recognition[31]	(396)	–
Income taxes on items taken directly to or transferred from equity[31]	(135)	231
Net income recognised directly in equity	(1,220)	2,083
Net income recognised in income statement	9,171	6,866
Total recognised income and expense	7,951	8,949
Attributable to		
– Roche shareholders[31]	7,198	7,406
– Minority interests[33]	753	1,543
Total	7,951	8,949
Effect of changes in accounting policy attributable to		
– Roche shareholders[1]	–	(1,257)
– Minority interests[1]	–	(5)
Total	–	(1,262)

As disclosed in Note 1, the statement of recognised income and expense for 2005 has been restated following the changes in IFRS that were adopted effective 1 January 2006. A reconciliation to the previously published statement of recognised income and expense is provided in Note 1.

Consolidated statement of changes in equity *in millions of CHF*

	Roche shareholders	Minority interests	Total
Year ended 31 December 2005			
At 1 January 2005 – as previously reported	27,998	5,285	33,283
Changes in accounting policy[1]	(1,257)	(5)	(1,262)
At 1 January 2005 – restated	26,741	5,280	32,021
Net income recognised directly in equity	1,483	600	2,083
Net income recognised in income statement	5,923	943	6,866
Total recognised income and expense	7,406	1,543	8,949
Dividends paid[31, 33]	(1,721)	(68)	(1,789)
Transactions in own equity instruments[31]	841	–	841
Equity compensation plans[31, 33]	1,494	1,131	2,625
Genentech share repurchases[31, 33]	(1,398)	(1,113)	(2,511)
Convertible debt instruments[31, 33]	–	22	22
Changes in minority interests[31, 33]	(29)	29	–
At 31 December 2005	33,334	6,824	40,158
Year ended 31 December 2006			
At 1 January 2006	33,334	6,824	40,158
Net income recognised directly in equity	(682)	(538)	(1,220)
Net income recognised in income statement	7,880	1,291	9,171
Total recognised income and expense	7,198	753	7,951
Dividends paid[31, 33]	(2,152)	(105)	(2,257)
Transactions in own equity instruments[31]	1,383	–	1,383
Equity compensation plans[31, 33]	726	450	1,176
Genentech share repurchases[31, 33]	(696)	(552)	(1,248)
Convertible debt instruments[31, 33]	(354)	5	(349)
Changes in minority interests[31, 33]	5	(5)	–
At 31 December 2006	39,444	7,370	46,814

Notes to the Roche Group 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

The consolidated financial statements of the Roche Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law. 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 1 February 2007 and are subject to approval by the Annual General Meeting of shareholders on 5 March 2007.

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 judgement 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 Holding Ltd, a company registered in Switzerland, and its subsidiaries ('the Group').

The subsidiaries are those companies controlled, directly or indirectly, by Roche Holding Ltd, 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 Holding Ltd owns, either directly or indirectly, more than 50% of the voting rights or 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 Group. Companies acquired during the year are consolidated from the date on which control is transferred to the Group, and subsidiaries to be divested are included up to the date on which control passes from the Group. Inter-company balances, transactions and resulting unrealised income are eliminated in full.

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

Segment reporting

The Group's primary format for segment reporting is business segments and the secondary format is geographical segments. The risks and returns of the Group's operations are primarily determined by the different products that the Group produces rather than the geographical location of the Group's operations. This is reflected by the Group's management and organisational structure and internal financial reporting systems.

The determination of the Group's business and geographical segments is based on the organisation units for which information is reported to the Group's management. The Group has two divisions, Pharmaceuticals and Diagnostics. Within the Pharmaceuticals Division there are three sub-divisions, Roche Pharmaceuticals, Genentech and Chugai. The three sub-divisions have separate management and reporting structures within the Pharmaceuticals Division and are considered separately reportable business segments. The Vitamins and Fine Chemicals business and the Consumer Health (OTC) business were previously separately reportable business segments. These have been divested and are presented as discontinued businesses. Certain headquarter activities are reported as 'Corporate'. These consist of corporate headquarters, including the corporate executive committee, corporate communications, corporate human resources, corporate finance, including treasury, taxes and pension fund management, corporate legal and corporate safety and environmental services. The Group's geographical segments are determined by geographical location and similarity of economic environments.

Transfer prices between business segments are set on an arm's length basis. Divisional assets and liabilities consist of property, plant and equipment, goodwill and intangible assets, trade receivables/payables and inventories. Other segment liabilities consist of other liabilities, such as provisions, which can be reasonably attributed to the reported business segments. Non-segment assets and liabilities mainly include current and deferred income tax balances, post-employment benefit assets/liabilities and financial assets/liabilities. These are principally cash, marketable securities, other investments and debt. Capital expenditure comprises additions to goodwill, intangible assets and property, plant and equipment, including those arising from business combinations.

Foreign currency translation

Most Group companies use their local currency as their functional currency. Certain Group companies use other currencies (namely US dollars, Swiss francs or euros) as their functional currency where this is the currency of the primary economic environment in which the entity operates. 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 when they are qualifying cash flow hedges or arise on monetary items that, in substance, form part of the Group's net investment in a foreign entity, which are deferred into equity.

Upon consolidation, assets and liabilities of Group companies using functional currencies other than Swiss francs (foreign entities) are translated into Swiss francs using year-end rates of exchange. Sales, costs, expenses, net income and cash flows are translated at the average rates of exchange for the year. Translation differences due to the changes in exchange rates between the beginning and the end of the year and the difference between net income translated at the average and year-end exchange rates are taken directly to equity. On disposal of a foreign entity, the identified cumulative currency translation differences within equity relating to that foreign entity are recognised in income as part of the gain or loss on divestment.

Revenues and cost of sales

Sales represent amounts received and receivable for goods supplied to customers after deducting trade discounts, cash discounts and volume rebates, and exclude sales and value added taxes. Revenues from the sale of products are recognised 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, charge-backs and other rebates, including Medicaid in the United States and similar rebates in other countries, are also deducted from sales and recorded as a deduction from accounts receivable or as accrued liabilities or provisions. Such estimates are based on analyses of existing contractual or legislatively-mandated obligations, historical trends and the Group'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 includes the corresponding direct production costs and related production overheads of goods sold and services rendered. Start-up costs between validation and the achievement of normal production capacity are expensed as incurred.

Royalty income and expenses
Royalty income and expenses are recognised on an accrual basis. Royalty expenses directly linked to goods sold are included in 'Cost of sales'. Other royalty expenses are included in 'General and administration'.

Research and development
In addition to its internal research and development activities, the Group is also party to in-licensing and similar arrangements with its alliance partners. Furthermore the Group may 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 capitalised 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 Group does not currently have any such internal development costs that qualify for capitalisation as intangible assets. Other internal development costs are 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 capitalised as intangible assets as described below. Once available for use, such intangible assets are amortised on a straight-line basis over the period of the expected benefit and are reviewed for impairment at each balance sheet date.

Licensing, milestone and other upfront receipts and payments
Certain 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 recognised based on achievement of the deliverables as defined in the respective agreements. Upfront payments and licence fees for which there are subsequent deliverables are initially reported as deferred income and are recognised as revenue in income as earned over the period of the development collaboration or the manufacturing obligation.

Payments made by Group companies to third parties and associated companies for such items are capitalised as intangible assets.

Receipts and payments between consolidated subsidiaries, such as between Genentech, Chugai and other Roche Group subsidiaries, are eliminated on consolidation.

Taxation
Income taxes include all taxes based upon the taxable profits of the Group, including withholding taxes payable on the distribution of retained earnings within the 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 recognised where it is probable that such earnings will be remitted in the foreseeable future.

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

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 Group operates.

Discontinued businesses and non-current assets held for sale

A discontinued business is a component of the Group's business that represents a separate major line of business or geographical area of operations 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 reclassification as held for sale, disposal groups are recognised at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the income statement.

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 Group. Where the 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 Group companies. The Group'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 in the country concerned. 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 business 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 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 unrecognised 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 Group participate in equity compensation plans, including separate plans at Genentech and Chugai. 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 and any subsequent cash flows from exercises of vested awards are recorded as an increase 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 exercises 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.

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 items. 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. Borrowing costs are not capitalised.

Leases

Where the Group is the lessee, leases of property, plant and equipment where the Group has substantially all of the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised 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 the Group's policy on property, plant and equipment. If there is no reasonable certainty that the 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 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 Group is the lessor, assets subject to finance leases are 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 recognised over the term of the lease based on the effective interest rate method. Lease income from operating leases is recognised 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 Group. The cost of acquisition also includes directly attributable costs. The acquired net assets, being the identifiable assets, liabilities and contingent liabilities, are initially recognised at fair value. Where the Group does not acquire 100% ownership of the acquired company, minority interest is recorded as the minority's proportion of the fair value of the acquired net assets. Goodwill is recorded as the surplus of the cost of acquisition over the 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 and are recorded in the functional currency of that company. Goodwill is not amortised, 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 associated companies, being the surplus of the cost of investment over the Group's share of the fair value of the net identifiable assets. Such goodwill is recorded within investments in associated companies.

Intangible assets

Purchased patents, licences, 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 amortised 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. Amortisation and impairment of intangible assets is presented separately in the income statement due to the materiality of the amounts and in order to fairly present the Group's results.

Impairment of property, plant and equipment and intangible assets

When there is evidence that an asset may be impaired, the recoverable amount of the asset is calculated and an impairment assessment is carried out. 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 amount, then the carrying amount 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/amortisation charge is accelerated. The impairment of financial assets is discussed below in the 'financial assets' policy.

Impairment of goodwill

An impairment assessment of goodwill is carried out annually. Goodwill is allocated to cash-generating units as described in Note 16. 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 amount, then an impairment in the carrying amount is recorded. The methodology used in the impairment testing is further described in Note 16.

Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of finished goods and work in process includes raw materials, direct labour and other directly attributable costs and overheads based upon the normal capacity of production facilities. Borrowing costs are not included. Cost is determined using the weighted average method. Net realisable 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 amount and the recoverable amount where there is objective evidence that the 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 the Group's experience. Long-term accounts receivable are discounted to take into account the time value of money, where material. Provisions for sales returns and sales charge-backs are reported as provisions and accrued liabilities, respectively.

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 recognised 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 recognised when the 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 foreign currency effects arising from their translation from their functional currency into Swiss francs and 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 recognised, 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 estimation techniques such as option pricing models and estimated discounted values of cash flows. The fair values of financial assets and liabilities at the balance sheet date are approximately in line with 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 Group has the intent and ability to hold until maturity. Loans and receivables are loans and other long-term financial assets created by the 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 designated as fair-value-through-profit-or-loss, which exclude transaction costs. All purchases and sales are recognised 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 amortised cost using the effective interest rate method. Available-for-sale financial assets are subsequently carried at fair value, with all unrealised 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 recognised in equity are included in financial income for the current period. Loans and receivables are subsequently carried at amortised cost.

Financial assets are 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. Any available-for-sale financial assets 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 financial assets that have a market value below their original cost, net of any previous impairment, for a sustained six-month period will 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 amortised 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.

Financial assets are derecognised when the contractual rights to the cash flows of the assets expire or when the Group sells or otherwise disposes of the contractual rights to the cash flows, including situations where the Group retains the contractual rights but assumes a contractual obligation to pay the cash flows to a third party.

Derivatives

Derivative financial instruments are initially recorded and subsequently carried at fair value. Apart from those derivatives designated as qualifying cash flow hedging instruments (see below), all changes in fair value are recorded as financial income in the period in which they arise. Embedded derivatives are recognised separately if not closely related to the host contract and where the host contract is carried at amortised 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 recognised 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, 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 a firm commitment or highly probable forecasted transaction that results in the recognition of a non-financial asset or liability, the cumulative changes of 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 of 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 amortised cost using the effective interest method. Any discount between the net proceeds received and the principal value due on redemption is amortised over the duration of the debt instrument and is recognised 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 30.

A bifurcation is carried out upon the issue of convertible debt instruments. The initial carrying value of the liability element is calculated using the market interest rate for an equivalent non-convertible instrument. The remainder of the net proceeds is allocated to the equity conversion option, which is reported in equity, and to deferred income tax liabilities. The liability element is subsequently reported at amortised cost, or fair-value-through-profit-and-loss if so designated.

Own equity instruments
The Group's holdings in its own equity instruments are recorded as a deduction from equity. The original purchase cost, consideration received for subsequent resale of these equity instruments and other movements are reported as changes in equity. These instruments have been acquired primarily to meet the obligations that may arise in respect of certain of the Group's debt instruments.

Management judgements made in applying accounting policies
The application of the Group's accounting policies may require management to make judgements, apart from those involving estimates, that can have a significant effect on the amounts recognised in the consolidated financial statements. Management judgement 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 the Group'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. The Group 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 recognised when, in management's judgement, the significant risks and rewards of ownership have been transferred and when the 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 recognised as deferred income and then released to income over subsequent periods on the basis of the performance of the conditions specified in the agreement.

Leases: The 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 judgement about whether substantially all of the risks and rewards of ownership are transferred.

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 judgements 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 recognised 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 Group has accruals and provisions for expected sales returns, charge-backs and other rebates, including Medicaid in the United States and similar rebates in other countries, which at 31 December 2006 total 762 million Swiss francs. Such estimates are based on analyses of existing contractual or legislatively-mandated obligations, historical trends and the Group's experience. Management believes that the total accruals and provisions 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 accruals and provisions recognised in the balance sheet in future periods and consequently the level of sales recognised in the income statement in future periods.

Property, plant and equipment and intangible assets, including goodwill: The Group has property, plant and equipment with a carrying value of 16,417 million Swiss francs as disclosed in Note 15. Goodwill has a carrying value of 5,914 million Swiss francs (see Note 16) and intangible assets have a carrying value of 5,469 million Swiss francs (see Note 17). 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 for products with capitalised rights could result in shortened useful lives or impairment.

Pensions and other post-employment benefits: Many of the Group's employees participate in post-employment defined benefit plans. The calculations of the recognised 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, the Group's independent actuaries use statistically based assumptions covering areas such as future withdrawals of participants from the plan and estimates on life expectancy. At 31 December 2006 the present value of the Group's defined benefit obligation is 11,002 million Swiss francs for funded plans and 3,596 million Swiss francs for unfunded plans (see Note 13). 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 recognised in the balance sheet in future periods.

Legal provisions: Group companies are party to various legal proceedings and the most significant matters are described in Notes 7 and 28. Legal provisions at 31 December 2006 total 1,320 million Swiss francs, as disclosed in Note 28. 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 recognised in the balance sheet in future periods.

Environmental provisions: The Group has provisions for environmental remediation costs, which at 31 December 2006 total 186 million Swiss francs, as disclosed in Note 28. 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 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 recognised in the balance sheet in future periods.

Income taxes: At 31 December 2006, the net liability for current income taxes is 1,776 million Swiss francs and the net liability for deferred income taxes is 375 million Swiss francs, as disclosed in Note 9. 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 recognised liabilities for income tax-related uncertainties are adequate. Various internal and external factors may have favourable or unfavourable 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 recognised in the balance sheet in future periods.

Changes in accounting policies

The Group adopted certain new and revised International Financial Reporting Standards and interpretations effective 1 January 2006. A description of those changes that are material to the Group and their effect on the consolidated financial statements is given below.

IAS 19 (revised): 'Employee Benefits'. Amongst other matters, the revised standard allows actuarial gains and losses from defined benefit plans to be recorded directly to equity. In this case adjustments arising from the limits on the recognition of assets for defined benefit plans are also to be recorded directly to equity. The revised standard requires retrospective application. In addition the Group now reports the expected return on plan assets and interest costs from defined benefit plans as part of financial income and financing costs, respectively, and the corresponding post-employment benefit assets and liabilities are included in non-segment assets and liabilities in the segment reporting. This change in presentation aligns the reporting of the Group's results more closely with its internal management and organisation structure.

Further information on the Group's pension and other post-employment benefits is given in Note 13.

Presentation of income statement: The income statement for the year ended 31 December 2005 has been restated following the changes in IFRS that were adopted effective 1 January 2006. In addition the Group has made certain presentational changes to further improve comparability of its results to those of other healthcare companies and to allow readers to make a more accurate assessment of the sustainable earnings capacity of the Group. These changes, which have been applied retrospectively, are listed below.

- Support costs for leased diagnostics instruments are now reported as part of 'Cost of sales' instead of 'Marketing and distribution'. In 2006 these were 114 million Swiss francs (2005: 76 million Swiss francs).

Restated income statement for the year ended 31 December 2005 *in millions of CHF*

	As originally published	IAS 19 (revised)	Group restated
Sales	35,511	–	35,511
Other operating items	(26,842)	164	(26,678)
Operating profit	8,669	164	8,833
Financial and non-operating items	297	32	329
Profit before taxes	8,966	196	9,162
Income taxes	(2,224)	(60)	(2,284)
Profit from continuing businesses	6,742	136	6,878
Profit from discontinued businesses	(12)	–	(12)
Net income	6,730	136	6,866
Attributable to			
– Roche shareholders	5,787	136	5,923
– Minority interests	943	–	943
Earnings per share and non-voting equity security			
Basic – Group (CHF)	6.85	0.16	7.01
Diluted – Group (CHF)	6.71	0.16	6.87

Presentation of the balance sheet: The balance sheet at 31 December 2005 has been restated as a result of the changes in IFRS that were adopted effective 1 January 2006. As a result of the implementation of IAS 19 (revised) post-employment benefit assets were 997 million Swiss francs lower, deferred income tax assets were 827 million Swiss francs higher, post-employment benefit liabilities were 1,471 million Swiss francs higher and deferred income tax liabilities were 56 million Swiss francs lower.

Restated balance sheet at 31 December 2005 *in millions of CHF*

	As originally published	IAS 19 (revised)	Group restated
Non-current assets	33,739	(170)	33,569
Current assets	35,626	–	35,626
Total assets	69,365	(170)	69,195
Non-current liabilities	(18,130)	(1,415)	(19,545)
Current liabilities	(9,492)	–	(9,492)
Total liabilities	(27,622)	(1,415)	(29,037)
Total net assets	41,743	(1,585)	40,158
Minority interests	6,821	3	6,824
Equity	34,922	(1,588)	33,334

Presentation of recognised income and expense and changes in equity: The new and revised standards that were adopted effective 1 January 2006 result in significant changes to the format and content of changes in equity. IAS 19 (revised) requires retrospective implementation. Accordingly opening equity for 2005 and the statement of recognised income and expense for 2005 have been restated.

Restated equity for 1 January 2005 *in millions of CHF*

	As originally published	IAS 19 (revised)	Group restated
Share capital	160	–	160
Own equity instruments	(4,326)	–	(4,326)
Retained earnings	35,960	(1,257)	34,703
Fair value reserve	344	–	344
Hedging reserve	(18)	–	(18)
Translation reserve	(4,122)	–	(4,122)
Equity attributable to Roche shareholders	27,998	(1,257)	26,741
Minority interests	5,285	(5)	5,280
Total equity	33,283	(1,262)	32,021

Restated recognised income and expense for the year ended 31 December 2005 *in millions of CHF*

	As originally published	IAS 19 (revised)	Group restated
Net income recognised directly in equity	2,542	(459)	2,083
Net income recognised in income statement	6,730	136	6,866
Total recognised net income	9,272	(323)	8,949
Attributable to			
– Roche shareholders	7,737	(331)	7,406
– Minority interests	1,535	8	1,543
Total	9,272	(323)	8,949

Future changes in IFRS: The Group is currently assessing the potential impacts of the new and revised standards that will be effective from 1 January 2007. The Group does not expect that the new and revised standards and interpretations will have a significant effect on the Group's results and financial position, although they will expand financial statement disclosure in certain areas, notably IFRS 7 'Financial Instruments: Disclosures' which the Group will implement in 2007. The Group is also in the process of evaluating IFRS 8 'Operating Segments' which will be effective from 1 January 2009.

2. Financial risk management

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

The Group's subsidiaries Genentech and Chugai have their own treasury operations. These have operational independence, whilst working within a financial risk management framework that is consistent with the rest of the Group. More information on their financial risks is available in the annual reports of Genentech and Chugai.

Financial risk management within the Group is governed by policies and guidelines approved by senior management. These policies and guidelines cover foreign exchange risk, interest rate risk, market risk, credit risk and liquidity risk. Group policies and guidelines also cover areas such as cash management, investment of excess funds and the raising of short- and long-term debt. Compliance with the policies and guidelines is managed by segregated functions within the Group.

The objective of financial risk management is to contain, where deemed appropriate, exposures in the various types of financial risks mentioned above in order to limit any negative impact on the Group's results and financial position.

The Group actively measures, monitors and manages its financial risk exposures by various functions pursuant to segregation-of-duties principles.

In accordance with its financial risk policies, the Group manages its market risk exposures through the use of financial instruments such as derivatives, when deemed appropriate. It is the Group's policy and practice not to enter into derivative transactions for trading or speculative purposes, nor for purposes unrelated to the underlying business.

Foreign exchange risk

The Group operates across the world and is exposed to movements in foreign currencies affecting its net income and financial position, as expressed in Swiss francs. The Group actively monitors its currency exposures and, when appropriate, enters into transactions with the aim of preserving the value of assets, commitments and anticipated transactions. The Group uses forward contracts, foreign exchange options and cross-currency swaps to hedge certain committed and anticipated foreign exchange flows and financing transactions.

Transaction exposure arises because the amount of local currency paid or received for transactions denominated in foreign currencies may vary due to changes in exchange rates. Similarly, transaction exposure arises on net balances of monetary assets held in foreign currencies. For many Group companies revenues and operating expenses are primarily in the local currency. At local level, the Group companies manage this exposure, if necessary, by means of financial instruments such as options and forward contracts. In addition, Group Treasury monitors total worldwide exposure on a monthly basis.

Translation exposure arises from the consolidation of the foreign currency denominated financial statements of the Group's foreign subsidiaries. The effect on the Group's consolidated equity is shown as a currency translation movement. The Group partially hedges net investments in foreign currencies by taking out foreign currency loans or issuing foreign currency denominated debt instruments. Major translation exposures are monitored regularly.

A significant part of the Group's cash outflows for research, development, production and administration is denominated in Swiss francs, while a much smaller proportion of the Group's cash inflows are Swiss franc denominated. As a result, an increase in the value of the Swiss franc relative to other currencies has an adverse impact on consolidated net income. Similarly, a relative decrease in the value of the Swiss franc has a favourable effect on results when reported in Swiss francs.

Interest rate risk

Interest rate risk arises from movements in interest rates which could have effects on the Group's net income or financial position. Changes in interest rates may cause variations in interest income and expenses resulting from interest-bearing assets and liabilities. In addition, they can affect the market value of certain financial assets, liabilities and instruments as described in the following section on market risk of financial assets. The interest rates on the Group's major debt instruments are fixed, as described in Note 30. The Group uses interest rate derivatives to manage its interest rate risk.

Market risk of financial assets

Changes in the market value of certain financial assets and derivative instruments can affect the net income or financial position of the Group. Financial long-term assets are held for strategic purposes and marketable securities are held for fund management purposes. The risk of loss in value is managed by reviews prior to investing and continuous monitoring of the performance of investments and changes in their risk profile. Investments in equities, bonds, debentures and other fixed income instruments are entered into on the basis of guidelines with regard to liquidity and credit rating.

Credit risk

Credit risk arises from the possibility that the counterparty to a transaction may be unable or unwilling to meet their obligations causing a financial loss to the Group. Trade receivables are subject to a policy of active risk management which focuses on the assessment of country risk, credit availability, ongoing credit evaluation and account monitoring procedures. Except as noted below, there are no significant concentrations within trade receivables of counterparty credit risk due to the Group's large number of customers and their wide geographical spread. For some credit exposures in critical countries, the Group has obtained credit insurance. Country risk exposures are continuously monitored. The exposure of other financial assets to credit risk is controlled by setting a policy for limiting credit exposure to high-quality counterparties, regular reviews of credit ratings, and setting defined limits for each counterparty. Where appropriate to reduce exposure, netting agreements under an ISDA (International Swaps and Derivatives Association) master agreement are signed with the respective counterparties. The maximum exposure to credit risk resulting from financial activities, without considering netting agreements, is equal to the carrying amount of financial assets plus the positive fair value of derivative instruments. The credit exposure is diversified amongst different counterparties.

At 31 December 2006 the Group's combined trade accounts receivable balance with three US national wholesale distributors, AmerisourceBergen Corp., Cardinal Health, Inc. and McKesson Corp., was equivalent to 1.5 billion Swiss francs representing 17% of the Group's consolidated trade accounts receivable (2005: 1.1 billion Swiss francs representing 14%).

Liquidity risk

Group companies require sufficient availability of cash to meet their obligations. Individual companies are generally responsible for their own cash management, including the short-term investment of cash surpluses and the raising of loans to cover cash deficits, subject to guidance by the Group and, in certain cases, to approval at Group level. The Group maintains sufficient reserves of cash and readily realisable marketable securities to meet its liquidity requirements at all times. In addition, the strong international creditworthiness of the Group provides the ability to efficiently use international capital markets for financing purposes. The Group has unused committed credit lines with various financial institutions totalling 4.3 billion Swiss francs. This includes a syndicated credit facility of 2.5 billion euros and bank commitment lines of 30 billion Japanese yen at Chugai.

3. Segment information

Divisional information *in millions of CHF*

	Roche Pharmaceuticals 2006	Roche Pharmaceuticals 2005	Genentech 2006	Genentech 2005	Chugai 2006	Chugai 2005
Segment revenues						
Segment revenues/divisional sales	21,481	17,474	9,576	6,834	3,503	3,699
Less inter-divisional sales	(815)	(519)	(451)	(220)	–	–
Divisional sales to third parties	20,666	16,955	9,125	6,614	3,503	3,699
Segment results						
Operating profit before exceptional items	6,025	4,618	3,951	2,124	569	797
Major legal cases	–	(210)	–	–	–	–
Segment results/operating profit	6,025	4,408	3,951	2,124	569	797
Segment assets and liabilities						
Divisional/segment assets	14,704	13,532	10,078	8,572	3,344	3,732
Non-segment assets						
Total assets						
Divisional liabilities	(558)	(585)	(394)	(423)	(90)	(75)
Other segment liabilities	(982)	(1,028)	(987)	(919)	(3)	(26)
Segment liabilities	(1,540)	(1,613)	(1,381)	(1,342)	(93)	(101)
Non-segment liabilities						
Total liabilities						
Segmental expense information						
Research and development costs	3,304	2,768	1,998	1,634	587	568
Equity compensation plan expenses	121	140	510	293	1	1
Restructuring expenses	14	41	–	–	4	56
Capital expenditure						
Business combinations	–	276	–	–	–	–
Additions to property, plant and equipment	1,091	923	1,749	1,507	190	183
Additions to intangible assets	416	85	168	81	–	1
Total capital expenditure	1,507	1,284	1,917	1,588	190	184
Other segment information						
Depreciation of property, plant and equipment	544	503	298	215	82	74
Amortisation of intangible assets	410	417	164	183	72	76
Impairment of property, plant and equipment	38	39	–	–	2	27
Impairment of goodwill	–	–	–	–	–	–
Impairment of intangible assets	13	–	–	–	–	–
Income from associated companies	(1)	(1)	–	–	–	–
Investments in associated companies	–	7	–	–	–	–

	Pharmaceuticals Division 2006	Pharmaceuticals Division 2005	Diagnostics Division 2006	Diagnostics Division 2005	Corporate 2006	Corporate 2005	Group 2006	Group 2005
	34,560	28,007	8,753	8,249	–	–	43,313	36,256
	(1,266)	(739)	(6)	(6)	–	–	(1,272)	(745)
	33,294	27,268	8,747	8,243	–	–	42,041	35,511
	10,545	7,539	1,422	1,771	(237)	(121)	11,730	9,189
	–	(210)	–	(146)	–	–	–	(356)
	10,545	7,329	1,422	1,625	(237)	(121)	11,730	8,833
	28,126	25,836	14,262	14,550	123	125	42,511	40,511
							31,903	28,684
							74,414	69,195
	(1,042)	(1,083)	(338)	(287)	(19)	(1)	(1,399)	(1,371)
	(1,972)	(1,973)	(187)	(137)	(33)	(74)	(2,192)	(2,184)
	(3,014)	(3,056)	(525)	(424)	(52)	(75)	(3,591)	(3,555)
							(24,009)	(25,482)
							(27,600)	(29,037)
	5,889	4,970	700	702	–	–	6,589	5,672
	632	434	44	58	14	12	690	504
	18	97	17	2	–	–	35	99
	–	276	–	2	–	–	–	278
	3,030	2,613	846	813	2	2	3,878	3,428
	584	167	9	95	–	–	593	262
	3,614	3,056	855	910	2	2	4,471	3,968
	924	792	532	505	5	5	1,461	1,302
	646	676	331	335	–	–	977	1,011
	40	66	31	–	–	–	71	66
	–	–	–	–	–	–	–	–
	13	–	184	–	–	–	197	–
	(1)	(1)	3	1	–	1	2	1
	–	7	7	4	–	47	7	58

Information by geographical segment *in millions of CHF*

2006	Sales to third parties (by destination)	Segment assets	Capital expenditure
Switzerland	471	6,136	584
European Union	13,627	12,343	991
Rest of Europe	1,503	609	19
Europe	15,601	19,088	1,594
North America	16,670	17,921	2,467
Latin America	2,539	1,111	101
Japan	3,713	3,500	201
Rest of Asia	2,384	600	69
Asia	6,097	4,100	270
Africa, Australia and Oceania	1,134	291	39
Segment total	42,041	42,511	4,471
Non-segment assets	–	31,903	–
Consolidated total	42,041	74,414	4,471
2005			
Switzerland	501	5,777	766
European Union	11,570	11,532	922
Rest of Europe	1,206	371	27
Europe	13,277	17,680	1,715
North America	13,479	17,046	1,888
Latin America	2,033	1,061	63
Japan	3,948	3,916	197
Rest of Asia	1,803	539	75
Asia	5,751	4,455	272
Africa, Australia and Oceania	971	269	30
Segment total	35,511	40,511	3,968
Non-segment assets	–	28,684	–
Consolidated total	35,511	69,195	3,968

4. Genentech

Effective 7 September 1990 the Group acquired a majority interest of approximately 60% of Genentech, Inc., a biotechnology company in the United States. On 13 June 1999 the Group exercised its option to acquire the remaining shares of Genentech on 30 June 1999, at which point Genentech became a 100% owned subsidiary of the Group. On 23 July 1999, 26 October 1999 and 29 March 2000 the Group completed public offerings of Genentech's common stock, which reduced the Group's majority interest to 60%. During 2004 the Group's ownership of Genentech decreased by 2.45% due to the conversion and redemption of the 'LYONs IV' US dollar exchangeable notes. Genentech issues additional shares of common stock in connection with its equity compensation plans and also may issue additional shares for other purposes, which affects the Group's percentage ownership interest. The affiliation agreement between the Group and Genentech provides, amongst other things, that Genentech establish a stock repurchase programme to maintain the Group's percentage ownership interest in Genentech. At 31 December 2006 the Group's interest in Genentech was 55.8% (2005: 55.7%).

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 (US GAAP). These are filed on a quarterly basis with the US Securities and Exchange Commission (SEC).

Differences between IFRS and US GAAP

Due to certain consolidation entries and differences in the requirements of International Financial Reporting Standards (IFRS) and US GAAP, there are differences between Genentech's stand-alone financial results on a US GAAP basis and the financial results of Genentech as consolidated by the Roche Group in accordance with IFRS.

Reconciliation of Genentech results

	2006 USD millions	2006 CHF millions	2005 USD millions	2005 CHF millions
Operating income (US GAAP basis)	3,152		1,922	
– redemption costs	105		122	
– equity compensation plan expenses (US GAAP basis)	309		–	
– special litigation items	54		58	
Operating income (non-US GAAP basis)	3,620		2,102	
Add (deduct) differences and consolidation entries				
– add back redemption costs	(105)		(122)	
– equity compensation plan expenses (IFRS basis)	(407)		(235)	
– capitalised in-process research and development	104		15	
– other differences and consolidation entries	(60)		(54)	
Operating profit before exceptional items (IFRS basis)	3,152	3,951	1,706	2,124
Add (deduct) exceptional items				
– major legal cases		–		–
Segment result/operating profit (IFRS basis)		3,951		2,124
Add (deduct) non-operating items (IFRS basis)				
– financial income and financing costs		212		42
– income taxes		(1,730)		(777)
Net income (IFRS basis)		2,433		1,389
Minority interest percentage (average during year)		44.3%		44.3%
Income applicable to minority interest (IFRS basis)		1,077		616

Translated at 1 USD = 1.25 CHF (2005: 1 USD = 1.25 CHF).

Effective 1 January 2005 the Group implemented IFRS 2 'Share-based Payment' in its IFRS financial statements. Amongst other matters, the standard requires that the fair value of all equity compensation plans awarded 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. The standard also requires retrospective application, within certain transitional requirements. In 2006 a pre-tax expense of 407 million US dollars or 510 million Swiss francs relating to plans at Genentech has been recorded (2005: 235 million US dollars or 293 million Swiss francs). Due to the impact of the transitional requirements these amounts are not indicative of the future expenses for such plans. Effective 1 January 2006 Genentech implemented US Statement of Financial Accounting Standards No. 123R – 'Share-Based Payment' (FAS 123R) in its US GAAP financial statements. Amongst other matters, this requires that companies reporting under US GAAP recognise compensation expenses for such plans. Due to the different dates of first application, measurement requirements and transitional arrangements of FAS 123R and IFRS 2, the expenses recorded by Genentech in its US GAAP financial statements for equity compensation plans are not the same as the expenses recorded in the Roche Group IFRS financial statements for these same plans.

In 2005 the Group implemented IAS 38 (revised) 'Intangible Assets' in its IFRS financial statements. Amongst other matters, the revised standard typically results in more intangible assets being recognised from in-licensing arrangements and similar research and development alliances. In Genentech's US GAAP financial statements such expenditure would usually be recorded as research and development expenses.

There are other differences between IFRS and US GAAP, but these have a relatively minor impact.

Genentech share repurchases

On 20 April 2006 Genentech's Board of Directors approved an extension of the existing stock repurchase programme authorising Genentech to repurchase up to 100 million shares of Genentech's common stock for a total of 6 billion US dollars through 30 June 2007. Since the programme's inception, Genentech has repurchased approximately 62 million shares for a total of approximately 4.4 billion US dollars. During 2006 Genentech repurchased common stock worth 996 million US dollars or 1,248 million Swiss francs (2005: 2,016 million US dollars or 2,511 million Swiss francs).

Manufacturing agreements with Lonza

Effective 8 December 2006 Genentech sold its wholly-owned subsidiary Genentech España, including the manufacturing facility in Porriño, Spain, to Lonza Group Ltd. ('Lonza') for 150 million US dollars. In 2006 11 million US dollars were received in cash and the remaining balance will be received from Lonza in a series of payments over the next three years. 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.

Loss on divestment of Genentech España *in millions of CHF*

	2006
Consideration	
– cash	14
– present value of unsecured receivables from Lonza	169
Total consideration	183
Net assets disposed	
– property, plant and equipment[15]	(192)
– other net assets	(7)
Loss on divestment	(16)

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 US 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 US dollars. 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 US dollars. Regardless of whether the purchase option is exercised, Genentech will be obliged to make a milestone payment of 70 million US dollars if certain performance milestones are met at the facility being constructed.

Genentech has also entered into a loan agreement with Lonza to advance up to 299 million US dollars to Lonza for the construction of the Singapore facility, the majority of which is not expected to be advanced until 2008. The majority of these funds will not be advanced to Lonza unless and until Lonza's securitisation obligations for such are mutually agreed upon by the parties. 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.

Oceanside biologics manufacturing facility

On 23 June 2005 Genentech completed the purchase of the Oceanside biologics manufacturing facility in San Diego, California, from Biogen Idec. The purchase cost, including closing costs, was 531 million Swiss francs.

Acquisition of Tanox

On 9 November 2006 Genentech announced plans to acquire a 100% controlling interest in Tanox, Inc. ('Tanox'), a publicly owned company listed on the NASDAQ under the symbol 'TNOX'. Tanox is a biotechnology company based in Houston, Texas, that specialises 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 commercialise Xolair. The expected purchase consideration, excluding transaction costs, is 919 million US dollars in cash. Funds will be provided from Genentech's cash on hand at the time of closing. On 15 January 2007 the transaction was approved by Tanox's shareholders. The transaction, which is subject to regulatory clearance, is expected to be completed in the first half of 2007.

Leasing arrangements

During the third quarter of 2005 Genentech paid 585 million US dollars to buy out the lease obligations in respect of its manufacturing facility at Vacaville, California and certain buildings on its South San Francisco site.

In December 2004 Genentech entered into a Master Lease Agreement with Slough SSF LLC ('Slough') 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. Slough 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 is expected to be 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 Slough consider selling part or all of the development.

As at 31 December 2006, based on the status of the development to date, the total carrying value of property, plant and equipment from this agreement, including tenant improvements, was 228 million Swiss francs and the carrying value of the leasing obligation was 219 million Swiss francs. 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 Slough leases *in millions of CHF*

	Principal	Ground lease	Interest	Total minimum lease payments
Within one year	6	5	12	23
Between one and five years	63	34	78	175
More than five years	293	83	87	463
Total	362	122	177	661

Other matters

Details of Genentech legal cases are given in Note 7. Details of Genentech's equity compensation plans are given in Note 14. Details of Genentech's Senior Notes are given in Note 30.

5. Chugai

Effective 1 October 2002 the Roche Group and Chugai completed an alliance to create a leading research-driven Japanese pharmaceutical company, which was formed by the merger of Chugai and Roche's Japanese pharmaceuticals subsidiary, Nippon Roche. The merged company, known as Chugai, is a fully consolidated subsidiary of the Group. At 31 December 2006 the Group's interest in Chugai was 50.6% (2005: 50.6%).

The common stock of Chugai is publicly traded and is listed on the Tokyo Stock Exchange under the stock code 'TSE:4519'. Chugai prepares financial statements in conformity with accounting principles generally accepted in Japan (JGAAP). These are filed on a quarterly basis with the Tokyo Stock Exchange.

Differences between IFRS and JGAAP

Due to certain consolidation entries and differences in the requirements of International Financial Reporting Standards (IFRS) and JGAAP, there are differences between Chugai's stand-alone financial results on a JGAAP basis and the financial results of Chugai as consolidated by the Roche Group in accordance with IFRS.

The acquisition by Roche of a 50.1% interest in Chugai is treated as a business combination for IFRS. For JGAAP the alliance is treated as a merger between Chugai and Nippon Roche. Therefore the JGAAP results of Chugai do not include the goodwill and fair value adjustments that are recorded in Roche's results, and which are quantified in the table below. Moreover the acquisition accounting only includes Roche's 50.1% of these fair value adjustments and therefore the impact of these on net income needs to be added back in the minority interest calculations in Roche's IFRS results.

In Roche's IFRS results, depreciation on property, plant and equipment is calculated using the straight-line method. In Chugai's JGAAP results the reducing balance method is used. Additionally certain income and expenses, notably some restructuring costs, are required by JGAAP to be reported as extraordinary items. In Chugai's JGAAP results extraordinary items are reported below the operating profit line. In Roche's IFRS results such items are normally included as part of operating profit and are not treated as extraordinary or exceptional items. Restructuring costs were 4 million Swiss francs (2005: 56 million Swiss francs). There are other differences between IFRS and JGAAP, but these have a relatively minor impact.

Reconciliation of Chugai results

	2006 JPY billions	2006 CHF millions	2005 JPY billions	2005 CHF millions
Operating profit (JGAAP basis)	58.3		79.2	
– depreciation basis difference	3.4		4.5	
– classification of extraordinary items	(0.2)		(3.3)	
– other differences and consolidation entries	(2.0)		(3.2)	
Chugai operating profit before exceptional items and before acquisition accounting impacts (IFRS basis)	59.5	641	77.2	873
– depreciation of property, plant and equipment	(0.7)	(7)	(0.7)	(8)
– amortisation of intangible assets arising from business combinations	(6.0)	(65)	(6.0)	(68)
Chugai operating profit before exceptional items (IFRS basis)	52.8	569	70.5	797
Add (deduct) exceptional items				
– major legal cases		–		–
Chugai segment result/operating profit (IFRS basis)		569		797
Add (deduct) Corporate and non-operating items (IFRS basis)				
– gain on settlement of defined benefit plans		–		127
– financial income and financing costs		20		11
– income taxes		(229)		(343)
Net income (IFRS basis)		360		592
Minority interest calculation				
Add back acquisition accounting impact on net income		49		52
Net income excluding acquisition accounting		409		644
Minority interest percentage (average during year)		49.4%		49.4%
Income applicable to minority interest (IFRS basis)		202		318

Translated at 100 JPY = 1.08 CHF (2005: 100 JPY = 1.13 CHF).

Dividends

The dividends distributed to third parties holding Chugai shares during 2006, including special dividends, totalled 100 million Swiss francs (2005: 65 million Swiss francs) and have been recorded against minority interests (see Note 33). Dividends paid by Chugai to Roche are eliminated on consolidation as inter-company items.

Restructuring of production facilities

On 28 February 2005 Chugai announced a restructuring of its production facilities, under which five existing plants will be integrated into two facilities within the next five to six years. As part of this restructuring the plant at Kagamiishi was sold during the first half of 2005. Total restructuring costs in 2005, including the loss on disposal of the Kagamiishi plant, were 56 million Swiss francs. This was shown as an extraordinary loss in Chugai's JGAAP financial statements.

Pensions and other post-employment benefits

In the second half of 2005 Chugai returned part of its employees' pension fund to the Japanese government. As a result of this there was a settlement gain of 127 million Swiss francs. In accordance with the Group's management and organisational structure this was reported as general and administration expenses within the Corporate business segment in the 2005 results. This was shown as an extraordinary gain in Chugai's JGAAP financial statements.

Other matters

Details of Chugai's equity compensation plans are given in Note 14. Details of the 'Series 6 Chugai Pharmaceutical Unsecured Convertible Bonds', including conversions during the year, are given in Note 30.

6. Royalties and other operating income

Royalties and other operating income *in millions of CHF*

	Pharmaceuticals		Diagnostics		Group	
	2006	2005	2006	2005	2006	2005
Royalty income	930	840	128	146	1,058	986
Income from out-licensing agreements	321	270	55	116	376	386
Gains on disposal of products	16	55	(1)	1	15	56
Other	10	11	7	8	17	19
Total royalties and other operating income	1,277	1,176	189	271	1,466	1,447

Income from out-licensing agreements

Certain 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 recognised based on achievement of the milestones, as defined in the respective agreements. Revenue from upfront payments and licence fees for which there are subsequent deliverables is initially reported as deferred income and is recognised in income as earned over the period of the development collaboration or the manufacturing obligation.

Gains on disposal of products

As part of the continuous realignment of its product portfolio, the Group periodically disposes of product lines that are no longer considered as core products or priorities within the product development portfolio. The proceeds are reinvested in the Group's in-licensing arrangements and other research and development alliances and collaborations.

7. Major legal cases

Income (expenses) from major legal cases *in millions of CHF*

	2006	2005
Roche Pharmaceuticals legal cases	–	(210)
Genentech legal cases	–	–
Diagnostics legal cases	–	(146)
Total income (expenses) from major legal cases – continuing businesses	–	(356)
Discontinued businesses – vitamin case	–	–
Group total	–	(356)

Income (expenses) from major legal cases (continuing businesses) is disclosed separately in the income statement due to the materiality of the amounts and in order to fairly present the Group's results. The total net cash outflow from major legal cases during the year was 31 million Swiss francs (2005: 180 million Swiss francs).

Roche Pharmaceuticals legal cases

Roche Diagnostics GmbH ('RDG') and SmithKline Beecham (Cork) Ltd ('SB') are party to arbitration concerning RDG's termination in 1998 of the Carvedilol License Agreement of 1987, as amended in 1995, relating to the licensing and co-marketing of carvedilol. RDG has submitted two claims for damages to two Arbitration Tribunals in Zurich and SB has submitted a counterclaim asserting the invalidity of RDG's termination and claiming damages. Based on the development of the current arbitration and settlement negotiations, the Group increased its existing provisions by 210 million Swiss francs in 2005. There have been no developments in 2006 that would require any further changes to the provisions already recorded by the Group. The total amount of provisions recorded by RDG is not disclosed as this may seriously prejudice RDG's position in this matter.

Genentech legal cases

On 10 June 2002 Genentech announced that a Los Angeles County Superior Court jury voted to award City of Hope Medical Center ('City of Hope') approximately 300 million US dollars in compensatory damages based on a finding of a breach of a 1976 agreement between Genentech and the City of Hope. On 24 June 2002 the jury voted to award City of Hope 200 million US dollars in punitive damages in the same case. On 13 September 2002 Genentech filed a notice of appeal of the jury verdict and damages awards with the California Court of Appeal. On 21 October 2004 the Court of Appeal affirmed the verdict and damages awards in all respects. Also, on 21 October 2004 Genentech announced that it would seek review by the California Supreme Court, which has discretion over which cases it will review. On 24 November 2004 Genentech filed its petition for review by the California Supreme Court and on 2 February 2005 the California Supreme Court granted this petition. The appeal to the California Supreme Court has been fully briefed and Genentech is waiting to be assigned an oral argument date. A full provision, which is classified as long-term, has been recorded for the damages awards. During the appeals process interest accrues on the total amount of the damages at a simple annual rate of 10%. Following the judgement, interest of 63 million Swiss francs (2005: 62 million Swiss francs) was recorded as the time cost of provisions, within financing costs. On 3 October 2002 Genentech entered into an arrangement with third-party insurance companies to post a surety bond in connection with this judgement. As part of this arrangement Genentech had pledged 735 million US dollars in cash and investments to secure this bond as at 31 December 2005. This was increased in 2006 by 53 million US dollars to 788 million US dollars. This amount, which is equivalent to 963 million Swiss francs at 31 December 2006, is reported as restricted cash within financial long-term assets (see Note 19).

On 4 October 2004 Genentech received a subpoena from the United States Department of Justice, requesting documents related to the promotion of Rituxan, a prescription product approved for the treatment of relapsed or refractory, low-grade or follicular, CD20-positive, B-cell non-Hodgkin's lymphoma. Genentech is co-operating with the associated investigation, which, as Genentech has been advised, is both civil and criminal in nature. The government has called and is expected to call former and current Genentech employees to appear before the grand jury in connection with this investigation. No provisions have been recorded in respect of this litigation as the outcome of this matter cannot be determined at this time.

On 11 April 2003 MedImmune, Inc. ('MedImmune') filed a lawsuit against Genentech, the City of Hope National Medical Center, and Celltech R&D Ltd., in the US District Court for the Central District of California, Los Angeles. The lawsuit relates to US 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. The lawsuit includes claims for violation of antitrust, patent and unfair competition laws. On 14 January 2004 the US District Court granted summary judgement against all of MedImmune's antitrust and unfair competition claims. On 23 April 2004 the District Court granted a motion to dismiss all remaining claims in this case. On 18 October 2005 the US Court of Appeals for the Federal Circuit affirmed the judgement of the District Court in all respects. On 10 November 2005 MedImmune filed a petition with the US Supreme Court seeking a review of the decision to dismiss certain of its claims. The Supreme Court granted MedImmune's petition and the oral argument of this case before the Supreme Court occurred on 4 October 2006. On 9 January 2007 the Supreme Court issued a decision reversing the Federal Circuit's decision and remanding the case to the lower courts for further proceedings. The decision addresses the issue of whether MedImmune's patent and contract claims can go forward in the Federal Court and expresses no opinion regarding the merits of these claims. No provisions have been recorded in respect of this litigation as the outcome of this matter cannot be determined at this time.

On 13 May 2005 a request was filed by a third party for re-examination of the Cabilly patent. On 7 July 2005 the US Patent and Trademark Office ordered a re-examination of this patent. On 13 September 2005 the Patent Office issued an initial 'non-final' Office action rejecting the claims of the patent. Genentech filed a response on 25 November 2005 and the Patent Office has not yet acted on this response. A second re-examination request for this same patent was filed on 23 December 2005 by another third party and on 23 January 2006 the Patent Office granted the re-examination request. On 6 June 2006 the two re-examinations were combined by the Patent Office into a single re-examination. On 16 August 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 re-examination requests. Genentech filed its response on 30 October 2006 and the Patent Office has not yet acted on this response. 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 licences. The claims of the Cabilly patent remain valid and enforceable throughout the re-examination process. Because the re-examination process is ongoing, no provisions have been recorded in respect of this litigation as the final outcome of this matter cannot be determined at this time.

On 29 July 2005 a former Genentech employee, whose employment ended in April 2005, filed a non-public (Qui Tam) complaint under seal in the United States District Court for the District of Maine against Genentech and Biogen Idec, alleging violations of the False Claims Act and retaliatory discharge of employment. On 20 December 2005 the United States District Court filed notice of its election to decline intervention in the lawsuit. The complaint was subsequently unsealed and Genentech was served on 5 January 2006. Genentech filed a motion to dismiss the complaint and on 14 December 2006 the Magistrate Judge issued a Recommended Decision on this motion. The Magistrate Judge recommended granting Genentech's motion to dismiss all of the former employee's Qui Tam claims and recommended denying Genentech's motion solely as to the former employee's claim for retaliatory discharge of employment. The parties have filed objections with the District Court Judge concerning those portions of the Magistrate Judge's Recommended Decision for which review by the District Court Judge is sought. No provisions have been recorded in respect of this litigation as the potential outcome cannot be determined at this time.

On 24 March 2004 Mr Kourosh Dastghieb filed a lawsuit against Genentech in the U.S. District Court for the Eastern District of Pennsylvania. The lawsuit relates to Dastghieb's claim that, based on a relationship with Genentech in the mid-1990s, he is entitled to profits or proceeds from Genentech's Lucentis product. Dastghieb has asserted multiple claims for monetary damages, including a claim under an unjust enrichment theory that he is entitled to the entire net present value of Lucentis, which he claims is between approximately 1.4 billion US dollars and 4.1 billion US dollars. On 8 November 2006 a unanimous jury ruled against Dastghieb and in favour of Genentech on all claims and final judgement was entered in Genentech's favour. The plaintiff has filed a motion to challenge this judgement which is set for hearing in early 2007. No provisions have been recorded in respect of this litigation as the potential outcome 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 US 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.

Diagnostics legal cases

During 2005 provisions for certain litigation and arbitration matters in the Diagnostics Division were increased by 146 million Swiss francs. There have been no developments in 2006 that would require any further changes to the provisions already recorded by the Group.

On 9 October 2003 Applera Corporation ('Applera') filed suit against the Group in the Superior Court of California and filed a Notice of Arbitration with the American Arbitration Association. Both the Superior Court lawsuit and the arbitration demand made claims concerning the interpretation and enforcement of contracts between the Group and Applera for the commercialisation of the polymerase chain reaction (PCR) technology. The claims sought termination of certain contracts, declarations regarding rights and obligations under those contracts, and monetary damages and other relief in an unspecified amount for alleged breaches of various agreements between the parties. On 15 December 2003 the Group filed its response in the arbitration proceeding. On the same day, the Group also responded to Applera's complaint in the Superior Court proceeding by petitioning the Court to compel arbitration of the claims alleged by Applera and to stay the lawsuit pending completion of the arbitration. On 22 October 2004 the Court of Appeal of the State of California ruled that the petition to compel arbitration should be granted and remanded the case to the Superior Court, with directions to grant the petition. On 9 May 2005 the Group announced that a settlement agreement had been reached with Applera with regard to the outstanding litigation and arbitration related to contractual relationships involving rights to and commercialisation of polymerase chain reaction (PCR) technology.

In 1992 the Group filed a suit against the Promega Corporation ('Promega') alleging patent infringement and breach of a licence agreement relating to the polymerase chain reaction (PCR) technology. In May 2004 the US District Court of the Northern District of California decided that one of the patents concerned was unenforceable and rejected the breach of licence claim. On 12 November 2003 the Group was notified that Promega had filed a non-public (Qui Tam) action against the Group with the US District Court of the Eastern District of West Virginia in March 2000. This complaint, filed under the False Claims Act, alleged that the US Federal Government was overcharged in its purchase of PCR enzyme products. In July 2003 the US Federal Government notified the Court of its decision not to intervene in Promega's complaint and on 12 November 2003 the Court ordered the complaint of 2000 to be unsealed. The Group filed a motion to dismiss this complaint and on 20 August 2004 the Court dismissed the complaint with prejudice. On 12 September 2005 the Group announced that a settlement agreement had been reached with Promega with regard to all outstanding litigation related to polymerase chain reaction (PCR) technology.

Vitamin case

Following the settlement agreement with the US Department of Justice on 20 May 1999 regarding pricing practices in the vitamin market and the overall settlement agreement to a class action suit brought by the US buyers of bulk vitamins, the Group recorded provisions in respect of the vitamin case in 1999. These provisions were the Group's best estimate at that time of the total liability that may arise, taking into account currency movements and the time value of money. Provisions for legal fees were recorded separately. The Group recorded additional provisions in 2001 and 2002, based on the development of the litigation and settlement negotiations in the US, Europe and elsewhere.

On 17 January 2003 the District of Columbia Circuit Court of Appeals ruled in a class action litigation brought on behalf of non-US purchasers of bulk vitamins from the Group and other manufacturers that non-US plaintiffs may bring claims in US courts under US anti-trust laws for alleged damages suffered from transactions outside the United States. On 14 June 2004 the Supreme Court of the United States nullified the decision of the District of Columbia Circuit Court of Appeals. The Supreme Court remanded the case to the lower court to review alternative arguments which might permit such claims to proceed in the United States. On remand, on 28 June 2005 a panel of the District of Columbia Circuit Court of Appeals ruled unanimously that US courts do not have jurisdiction over the plaintiffs' claims and affirmed the initial dismissal of the complaint. On 26 October 2005 the plaintiffs petitioned the US Supreme Court for further discretionary review. On 9 January 2006 the US Supreme Court issued an order denying the plaintiffs' petition. On 1 March 2006 the plaintiffs filed a motion in the trial court seeking relief from the final judgement so that plaintiffs could advance European Union law claims in the trial court. The trial court has denied that motion, and the plaintiffs' time to appeal the trial court's ruling has expired. The Group considers this matter closed.

The Group is seeking to resolve the remaining outstanding issues; however the timing and the final amounts involved are uncertain. The remaining provisions are all considered as short-term as cash outflows are expected to arise during 2007. They are not discounted as the time value of money is not considered material in this case. As the litigation and negotiations progress, it is possible that the ultimate liability may be different from the amount of provisions currently recorded.

8. Financial income and financing costs

Financial income *in millions of CHF*

	Year ended 31 December 2006	2005
Gains on sale of equity securities	382	251
(Losses) on sale of equity securities	(2)	(26)
Dividend income	10	10
Gains (losses) on equity derivatives, net	9	41
Write-downs and impairments of equity securities	(9)	(18)
Net income from equity securities	390	258
Interest income	788	423
Gains on sale of debt securities	57	79
(Losses) on sale of debt securities	(67)	(86)
Net gains (losses) on financial assets at fair-value-through-profit-or-loss	2	–
Write-downs and impairments of long-term loans	–	–
Net interest income and income from debt securities	780	416
Expected return on plan assets of defined benefit plans[13]	636	635
Foreign exchange gains (losses), net	33	139
Gains (losses) on foreign currency derivatives, net	(57)	(173)
Net foreign exchange gains (losses)	(24)	(34)
Net other financial income (expense)	47	38
Total financial income	1,829	1,313

Financing costs *in millions of CHF*

	Year ended 31 December 2006	2005
Interest expense	(315)	(264)
Amortisation of discount on debt instruments	(40)	(62)
Gains (losses) on interest rate derivatives, net	(25)	(19)
Net gains (losses) on financial liabilities at fair-value-through-profit-or-loss	51	41
Time cost of provisions[28]	(74)	(78)
Interest cost of defined benefit plans[13]	(571)	(603)
Total financing costs	(974)	(985)

Net financial income *in millions of CHF*

	Year ended 31 December 2006	2005
Financial income	1,829	1,313
Financing costs	(974)	(985)
Net financial income	855	328
Financial result from Treasury management	790	296
Financial result from Pension management	65	32
Net financial income	855	328

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 (LIBOR) yield curve, and the market prices of the bonds. Due to there being no major credit spread movement relative to the swap yield curve during 2006, the change in fair value that is attributable to changes in the liabilities' credit risk component was zero (2005: loss of 10 million Swiss francs). 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 17 million Swiss francs (2005: gain of 17 million Swiss francs). Interest expense on liabilities at fair-value-through-profit-or-loss was 106 million Swiss francs (2005: 105 million Swiss francs).

9. Income taxes

Income tax expenses *in millions of CHF*

	2006	2005
Current income taxes	3,436	2,409
Adjustments recognised for current tax of prior periods	(24)	37
Deferred income taxes	24	(162)
Total charge for income taxes	3,436	2,284

Since the Group operates internationally, it is subject to income taxes in many different tax jurisdictions. The Group calculates its average expected tax rate as a weighted average of the tax rates in the tax jurisdictions in which the Group operates. The Group's effective tax rate can be reconciled to the Group's average expected tax rate as follows:

Reconciliation of the Group's effective tax rate *in millions of CHF*

	2006	2005
Average expected tax rate	26.4%	25.2%
Tax effect of		
– Utilisation of previously unrecognised tax losses	–0.2%	–0.2%
– Non-taxable income/non-deductible expenses	–0.1%	+0.1%
– Genentech equity compensation plans	+0.7%	0.0%
– Other differences	+0.5%	+0.3%
Continuing businesses before exceptional items effective tax rate	27.3%	25.4%

	2006 Profit before tax	2006 Income taxes	2006 Tax rate	2005 Profit before tax	2005 Income taxes	2005 Tax rate
Roche (excluding Genentech and Chugai)	7,835	(1,477)	18.9%	6,417	(1,299)	20.2%
Genentech[4]	4,163	(1,730)	41.6%	2,166	(777)	35.9%
Chugai[5]	589	(229)	38.9%	935	(343)	36.7%
Continuing businesses before exceptional items effective tax rate	12,587	(3,436)	27.3%	9,518	(2,419)	25.4%
Major legal cases[7]	–	–		(356)	135	
Group's effective tax rate	12,587	(3,436)	27.3%	9,162	(2,284)	24.9%

Income tax assets (liabilities) *in millions of CHF*

	2006	2005
Current income taxes		
Current income tax assets	258	299
Current income tax liabilities	(2,034)	(811)
Net current income tax asset (liability)	(1,776)	(512)
Deferred income taxes		
Deferred income tax assets	1,935	2,551
Deferred income tax liabilities	(2,310)	(3,462)
Net deferred income tax asset (liability)	(375)	(911)

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

Unrecognised tax losses: expiry *in millions of CHF*

	2006	2005
Within one year	1	–
Between one and five years	91	87
More than five years	89	51
Total unrecognised tax losses	181	138

Deferred income tax liabilities have not been established for the withholding tax and other taxes that would be payable on the unremitted earnings of certain foreign subsidiaries, as such amounts are currently regarded as permanently reinvested. These unremitted earnings totalled 33.6 billion Swiss francs at 31 December 2006 (2005: 29.4 billion Swiss francs).

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 recognised net assets (liabilities) *in millions of CHF*

	Property, plant and equipment, and intangible assets	Other temporary differences	Total
Year ended 31 December 2005			
Net deferred income tax asset (liability) at 1 January 2005 – as previously reported	(3,059)	639	(2,420)
Changes in accounting policy[1]	–	658	658
Net deferred income tax asset (liability) at 1 January 2005 – restated	(3,059)	1,297	(1,762)
(Charged) credited to the income statement	289	(127)	162
(Charged) credited to equity from other recognised gains and losses[31]	–	231	231
(Charged) credited to equity from equity compensation plans and other transactions with shareholders	–	418	418
Acquisition of GlycArt[10]	(42)	–	(42)
Currency translation effects and other	(216)	298	82
Net deferred income tax asset (liability) at 31 December 2005	(3,028)	2,117	(911)

	Property, plant and equipment, and intangible assets	Other temporary differences	Total
Year ended 31 December 2006			
Net deferred income tax asset (liability) at 1 January 2006	(3,028)	2,117	(911)
(Charged) credited to the income statement	231	(252)	(21)
(Charged) credited to equity from other recognised gains and losses[31]	–	(135)	(135)
(Charged) credited to equity from equity compensation plans and other transactions with shareholders	–	(11)	(11)
Currency translation effects and other	80	623	703
Net deferred income tax asset (liability) at 31 December 2006	(2,717)	2,342	(375)

10. Business combinations

Net cash outflows from acquisitions of subsidiaries and associated companies *in millions of CHF*

	2006	2005
GlycArt	–	(231)
Other acquisitions	–	(2)
Total net cash outflows from acquisitions	–	(233)

These amounts are net of any cash balances in the acquired company.

Acquisitions – 2006

There were no acquisitions in 2006. On 9 November 2006, Genentech announced plans to acquire a 100% controlling interest in Tanox, Inc., a US biotechnology company. This transaction, which is expected to close in the first half of 2007 subject to regulatory approval, is described in Note 4.

Acquisitions – 2005

GlycArt: Effective 25 July 2005 the Group acquired a 100% controlling interest in GlycArt Biotechnology Ltd. ('GlycArt'), a privately-owned biotechnology research company based in Schlieren, Zurich, in Switzerland. GlycArt is reported as part of the Roche Pharmaceuticals business segment. The purchase consideration paid was 235 million Swiss francs, which has been allocated as follows:

GlycArt acquisition: net assets acquired *in millions of CHF*

	Carrying value prior to acquisition	Carrying value upon acquisition
Goodwill	–	75
Intangible assets: in-process research and development	–	178
Intangible assets: core technology	–	20
Property, plant and equipment	3	3
Deferred income taxes	–	(42)
Cash	4	4
Other net assets (liabilities)	(3)	(3)
Total	4	235

Goodwill was recognised resulting from the premium paid for the acquisition. This represents synergies that can be obtained from the Group's existing business utilising the acquired core technology. Intangible assets for core technology are amortised on a straight-line basis over 14 years, beginning 1 August 2005. Intangible assets for in-process research and development will be amortised over their useful lives on a straight-line basis beginning from the point when they are available for use. Subsequent to the acquisition GlycArt contributed a net expense of 9 million Swiss francs to the Roche Pharmaceuticals business result in 2005. If GlycArt had been acquired on 1 January 2005, the revenues of the Group in 2005 would have been unchanged and the Group's net income in 2005 would have been lower by a further 7 million Swiss francs compared to the reported results.

11. Discontinued businesses

Profit from discontinued businesses *in millions of CHF*

	2006 Consumer Health (OTC)	2006 Vitamins and Fine Chemicals	2006 Total	2005 Consumer Health (OTC)	2005 Vitamins and Fine Chemicals	2005 Total
Segment revenues	–	–	–	44	–	44
Expenses	–	–	–	(48)	(1)	(49)
Operating profit before exceptional items	–	–	–	(4)	(1)	(5)
Operating profit	–	–	–	(4)	(1)	(5)
Financing costs	–	(5)	(5)	–	(11)	(11)
Profit before taxes	–	(5)	(5)	(4)	(12)	(16)
Income taxes	–	1	1	–	3	3
Business result	–	(4)	(4)	(4)	(9)	(13)
Gain (loss) on disposal	19	9	28	10	–	10
Income taxes	(2)	(2)	(4)	(9)	–	(9)
Profit on disposal	17	7	24	1	–	1
Profit from discontinued businesses	17	3	20	(3)	(9)	(12)
Earnings per share and non-voting equity security						
Basic (CHF)			0.02			–0.01
Diluted (CHF)			0.02			–0.01

Assets and liabilities of discontinued businesses *in millions of CHF*

	2006 Consumer Health (OTC)	2006 Vitamins and Fine Chemicals	2006 Total	2005 Consumer Health (OTC)	2005 Vitamins and Fine Chemicals	2005 Total
Property, plant and equipment	–	–	–	–	–	–
Other long-term assets	–	–	–	–	–	–
Current assets	–	–	–	4	–	4
Total assets	–	–	–	4	–	4
Provisions and non-current liabilities	(37)	(146)	(183)	(52)	(169)	(221)
Current liabilities	–	–	–	(21)	–	(21)
Total liabilities	(37)	(146)	(183)	(73)	(169)	(242)
Net assets	(37)	(146)	(183)	(69)	(169)	(238)

Significant cash flows of discontinued businesses *in millions of CHF*

	2006 Consumer Health (OTC)	2006 Vitamins and Fine Chemicals	2006 Total	2005 Consumer Health (OTC)	2005 Vitamins and Fine Chemicals	2005 Total
Operating cash flows	–	–	–	(4)	(1)	(5)
Major legal cases	–	(22)	(22)	–	(82)	(82)
Proceeds from disposal	(5)	–	(5)	2,902	–	2,902
Total significant cash inflows (outflows)	(5)	(22)	(27)	2,898	(83)	2,815

Divestment of Consumer Health (OTC) business

On 19 July 2004 the Group announced the sale of Roche Consumer Health, its global OTC (over-the-counter medicines) business, to the Bayer Group. Under the agreement with Bayer the majority of local businesses were transferred to Bayer at the end of 2004. The divestment of the remaining 2%, measured in terms of Roche Consumer Health sales to third parties, was completed in 2005. Under the terms of the agreement the majority of cash proceeds, totalling 2,886 million Swiss francs, were transferred to the Group on 1 January 2005. In addition the Group received a further 16 million Swiss francs during the first half of 2005 for the remaining part of the divestment that was completed in 2005. The calculations of the final amounts arising from the agreed purchase price adjustment mechanisms have been completed and as a result 5 million Swiss francs were transferred to Bayer in 2006. There was no effect on net income from this transfer as the amounts concerned were covered by accruals made in the initial calculation of the gain on disposal. The profit from disposal for 2006 consists of a release of 19 million Swiss francs in respect of certain accruals and provisions that are no longer required. The business results for 2005 include the remaining part of Roche Consumer Health that was transferred to Bayer in 2005. There were no significant cash flows other than the receipt of the divestment proceeds received from Bayer that are described above.

Divestment of Vitamins and Fine Chemicals business

Effective 30 September 2003 the Group completed the sale of its global Vitamins and Fine Chemicals business ('the VFC business') to the Dutch company DSM. Following the sale of the VFC business, certain assets and liabilities of the Vitamins and Fine Chemicals Division, mainly associated with the vitamin case, remain with the Group. The Group and DSM have signed an Indemnity and Co-operation Agreement under which the Group may provide DSM with certain indemnities and guarantees in connection with the vitamin case. In addition the Group has given DSM certain indemnities in respect of any remedial actions at the sites of the VFC business that may be required by environmental laws. Further arrangements were put in place regarding the utilisation of certain assets and certain purchasing contracts, as well as adopting DSM as a preferred supplier for pharmaceutical ingredients. Under one of these arrangements, the Group has guaranteed to purchase for a period of four years beginning 1 January 2004 products with a sales value totalling 100 million euros. The Group will reimburse DSM for 75% of any unutilised amounts. The other arrangements consist of certain residual obligations, which have been fully accrued for. The profit from disposal for 2006 consists of a release of 5 million Swiss francs in respect of certain accruals and provisions that are no longer required. The business results for 2006 include costs of 4 million Swiss francs (2005: 9 million Swiss francs), due mostly to the after-tax amortisation of discounted liabilities.

12. Employee benefits

Employee remuneration *in millions of CHF*

	2006	2005
Wages and salaries	7,632	6,739
Social security costs	891	827
Defined contribution post-employment plans	214	174
Operating expenses for defined benefit post-employment plans[13]	348	149
Equity compensation plans[14]	690	504
Other employee benefits	406	365
Employees' remuneration included in operating results	10,181	8,758
Expected return on plan assets for defined benefit post-employment plans[13]	(636)	(635)
Interest cost for defined benefit post-employment plans[13]	571	603
Total employees' remuneration	10,116	8,726

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 8).

13. Pensions and other post-employment benefits

The 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 the Group's long-term financial position. Most employees are covered by pension plans sponsored by 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, principally in the United States. Post-employment benefit plans are classified for IFRS as 'defined contribution plans' if the 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 the Group's potential obligation is relatively minor or has a relatively remote possibility of arising. Consequently most of the Group'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 Group to funds administered by third parties. Payments by the Group were 214 million Swiss francs (2005: 174 million Swiss francs). No assets or liabilities are recognised in the Group'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 the Group's contributions.

Defined benefit plans

The Group's major defined benefit plans are located in Switzerland, the United States, Germany, the United Kingdom and Japan. Plans are usually established as trusts independent of the Group and are funded by payments from the Group and by employees. In some cases, notably for the major defined benefit plans in Germany, the plan is unfunded and the 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 corporate level, and any settlement gains and losses resulting from changes in funding arrangements are reported as general and administration expenses within the Corporate business 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 unrecognised 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 CHF*

	2006 Pension plans	2006 Other post-employment benefit plans	2006 Total	2005 Pension plans	2005 Other post-employment benefit plans	2005 Total
Current service cost	334	18	352	291	15	306
Past service cost	(3)	–	(3)	(15)	–	(15)
(Gain) loss on curtailment	–	–	–	(15)	–	(15)
(Gain) loss on settlement	(1)	–	(1)	(127)	–	(127)
Total operating expenses	330	18	348	134	15	149
Expected return on plan assets	(606)	(30)	(636)	(605)	(30)	(635)
Interest cost	522	49	571	556	47	603
Total financial (income) expense	(84)	19	(65)	(49)	17	(32)
Total expense recognised in income statement	246	37	283	85	32	117

The funding of the Group's various defined benefit plans is overseen at a 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 Group's finances, the net asset/liability recognised on the Group's balance sheet corresponds to the over/under funding of the plan, adjusted for unrecognised past service costs. For unfunded plans, where the Group meets the pension obligations directly from its own financial resources, a liability for the defined benefit obligation is recorded in the Group's balance sheet. Pension assets and liabilities in different defined benefit plans are not offset unless the 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 present value of any future refunds from the plans or reductions in future contributions to the plans and any cumulative unrecognised past service costs. Amounts recognised 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 31 December *in millions of CHF*

	2006 Funded plans	2006 Unfunded plans	2006 Total	2005 Funded plans	2005 Unfunded plans	2005 Total
Fair value of plan assets	11,632	–	11,632	10,858	–	10,858
Defined benefit obligation	(11,002)	(3,596)	(14,598)	(10,976)	(3,630)	(14,606)
Over (under) funding	630	(3,596)	(2,966)	(118)	(3,630)	(3,748)
Unrecognised past service costs	(28)	–	(28)	(35)	–	(35)
Limit on asset recognition	(396)	–	(396)	–	–	–
Reimbursement rights	95	21	116	100	22	122
Net recognised asset (liability)	301	(3,575)	(3,274)	(53)	(3,608)	(3,661)
Reported as						
– Post-employment benefit assets	831	–	831	625	–	625
– Post-employment benefit liabilities	(625)	(3,596)	(4,221)	(778)	(3,630)	(4,408)
– Reimbursement rights[19]	95	21	116	100	22	122
Net recognised asset (liability)	301	(3,575)	(3,274)	(53)	(3,608)	(3,661)

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

Defined benefit plans: fair value of plan assets *in millions of CHF*

	2006	2005
At 1 January	10,858	9,922
Expected return on plan assets	636	635
Actuarial gains (losses)	626	547
Currency translation effects and other	(248)	502
Employer contributions	212	182
Employee contributions	42	40
Benefits paid – funded plans	(480)	(511)
Past service cost	–	–
Business combinations	–	–
Curtailments	–	–
Settlements	(14)	(459)
At 31 December	11,632	10,858
Invested as		
– Shares and other equity instruments	5,819	4,768
– Bonds, debentures and other debt instruments	4,405	4,920
– Property	478	559
– Other assets	930	611
Total	11,632	10,858

Included within the fair value of plan assets are 311 thousand of the Group's non-voting equity securities with a fair value of 68 million Swiss francs (2005: 200 thousand non-voting equity securities and written call options with a total fair value of 36 million Swiss francs).

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

	2006			2005		
	Pension plans	Other post-employment benefit plans	Total	Pension plans	Other post-employment benefit plans	Total
At 1 January	13,540	1,066	14,606	12,180	784	12,964
Current service cost	334	18	352	291	15	306
Interest cost	522	49	571	556	47	603
Employee contributions	42	–	42	40	–	40
Actuarial (gains) losses	(159)	24	(135)	1,091	8	1,099
Currency translation effects and other	(158)	(76)	(234)	570	251	821
Benefits paid – funded plans	(427)	(53)	(480)	(483)	(28)	(511)
Benefits paid – unfunded plans	(109)	(2)	(111)	(110)	(11)	(121)
Past service cost	2	–	2	4	–	4
Business combinations	–	–	–	–	–	–
Curtailments	–	–	–	(15)	–	(15)
Settlements	(15)	–	(15)	(584)	–	(584)
At 31 December	13,572	1,026	14,598	13,540	1,066	14,606
Of which						
– Funded plans	10,258	744	11,002	10,172	804	10,976
– Unfunded plans	3,314	282	3,596	3,368	262	3,630

Part of the cost of certain of the Group's other post-employment plans are reimbursed through government programmes. The reimbursement rights are reported in other long-term assets (see Note 19) and totalled 116 million Swiss francs at 31 December 2006 (2005: 122 million Swiss francs). Movements in the reimbursement rights primarily consist of currency translation effects of 8 million Swiss francs.

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 corporate management and the 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 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 Group's actuaries use mortality tables which take into account historic patterns and expected changes, such as further increases in longevity. The mortality tables used for the major schemes are

- Germany: Heubeck tables 2005G
- Japan: National Census (No. 19 Life Table)
- Switzerland: Swiss BVG 2005
- United Kingdom: non-pensioners – PA92C25 rated down one year
- United Kingdom: pensioners – PA92C10 rated down one year
- United States: RP2000 projected to 2010

Rates of employee turnover, disability and early retirement are based on historical behaviour within 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, which are in countries with stable currencies and interest rates, are shown below.

Defined benefit plans: financial actuarial assumptions

		2006		2005
	Weighted average	Range	Weighted average	Range
Discount rates	4.30%	2%–9%	3.74%	2%–9%
Expected rates of return on plan assets	5.82%	1%–9%	6.10%	2%–10%
Expected rates of salary increases	3.60%	2%–6%	2.94%	2%–9%
Medical cost trend rate	8.16%	7%–9%	7.20%	7%–10%

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, realised and unrealised 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 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 1,262 million Swiss francs (2005: 1,181 million Swiss francs).

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 behaviour within 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. Since the Group's major post-employment medical plans are for US employees, these rates are driven by developments in the United States. 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 CHF*

	2006 +1%	2006 –1%	2005 +1%	2005 –1%
Current service cost and interest cost	10	(7)	9	(8)
Defined benefit obligation	125	(99)	132	(106)

Funding summary

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

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

	2006	2005	2004	2003	2002
Funded plans					
– Fair value of plan assets	11,632	10,858	9,922	9,490	8,751
– Defined benefit obligation	(11,002)	(10,976)	(10,233)	(9,785)	(9,337)
– Over (under) funding	630	(118)	(311)	(295)	(586)
Unfunded plans					
– Defined benefit obligation	(3,596)	(3,630)	(2,731)	(2,626)	(2,420)
Increase (decrease) in funding status arising from experience adjustments					
– Fair value of plan assets	626	547	13	472	(1,717)
– Defined benefit obligation	(249)	49	77	(46)	(37)
Increase (decrease) in funding status arising from changes in actuarial assumptions					
– Fair value of plan assets	–	–	–	–	–
– Defined benefit obligation	384	(1,148)	(636)	(603)	304

Cash flows

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

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

	2006	2005
Employer contributions – funded plans	(212)	(182)
Benefits paid – unfunded plans	(111)	(121)
Total cash inflow (outflow)	(323)	(303)

Based on the most recent actuarial valuations, the Group expects that employer contributions for funded plans in 2007 will be approximately 210 million Swiss francs.

Amounts recorded in equity

The actuarial gains and losses recognised in the statement of recognised income and expense were gains of 761 million Swiss francs (2005: losses of 552 million Swiss francs). The cumulative amount at 31 December 2006 was gains of 209 million Swiss francs. (2005: losses of 552 million Swiss francs).

In addition 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 the cumulative unrecognised past service costs. Adjustments arising from this limit on asset recognition are recorded directly in equity. In 2006 this adjustment was 396 million Swiss francs (2005: zero).

14. Employee stock options and other equity compensation benefits

The Group operates several equity compensation plans, including separate plans at Genentech and Chugai. Effective 1 January 2005 the Group 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 CHF*

	2006	2005
Cost of sales	118	39
Marketing and distribution	149	113
Research and development	229	196
General and administration	194	156
Total operating expense	690	504
Share option plans		
Roche Option Plan	7	7
Genentech Stock Option Plan	468	266
Chugai Stock Acquisition Rights	1	1
Total share option plans	476	274
Other equity compensation plans		
Roche Connect	11	9
Genentech Employee Stock Purchase Program	42	27
Roche Stock-settled Stock Appreciation Rights	76	43
Roche Performance Share Plan	15	11
Roche Stock Appreciation Rights	70	140
Total other equity compensation plans	214	230
Total operating expense	690	504
Of which		
– equity-settled	620	364
– cash-settled	70	140

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

	2006	2005
Share option plans		
Roche Option Plan	55	76
Genentech Stock Option Plan	361	929
Chugai Stock Acquisition Rights	1	1
Total share option plans	417	1,006
Other equity compensation plans		
Roche Connect	(11)	(9)
Genentech Employee Stock Purchase Program	121	93
Roche Stock-settled Stock Appreciation Rights	(47)	–
Roche Performance Share Plan	–	–
Roche Stock Appreciation Rights	(107)	(91)
Total other equity compensation plans	(44)	(7)
Total cash inflow (outflow)	373	999
Of which		
– equity-settled	480	1,090
– cash-settled	(107)	(91)

Roche Long-Term: During 2005 the Group implemented a new global long-term incentive programme which is available to certain directors, management and employees selected at the discretion of the Group. The programme consists of Stock-settled Stock Appreciation Rights (S-SARs) with the Group having the alternative of granting awards under the existing Roche Option Plan.

Share option plans

Roche Option Plan: Awards under this plan give employees the right to purchase non-voting equity securities at an exercise price specified at the grant 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 Group covers such obligations by purchasing non-voting equity securities, or derivatives thereon (see Note 31). With the introduction of Roche Long-Term in 2005, the number of options granted under the Roche Option Plan was significantly reduced, as most eligible employees now receive Roche Stock-settled Stock Appreciation Rights instead.

Roche Option Plan – movement in number of options outstanding

	2006 Number of options (thousands)	2006 Weighted average exercise price (CHF)	2005 Number of options (thousands)	2005 Weighted average exercise price (CHF)
Outstanding at 1 January	1,854	105.85	2,457	102.40
Granted	141	195.14	199	123.27
Forfeited	(15)	123.52	(36)	108.18
Exercised	(564)	97.73	(766)	99.19
Expired	–	–	–	–
Outstanding at 31 December	1,416	117.83	1,854	105.85
– of which exercisable	894	103.00	770	100.41

Roche Option Plan – terms of options outstanding as at 31 December 2006

	Options outstanding			Options exercisable	
Year of grant	Number outstanding (thousands)	Weighted average years remaining contractual life	Weighted average exercise price (CHF)	Number exercisable (thousands)	Weighted average exercise price (CHF)
2002	118	2.19	115.23	118	115.23
2003	449	3.17	78.56	424	78.22
2004	545	4.17	129.50	308	129.50
2005	165	5.17	123.22	44	123.00
2006	139	6.17	195.15	–	–
Total	1,416	4.00	117.83	894	103.00

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 ten-year duration and vest on a phased basis over four years, subject to continued employment.

Genentech Stock Option Plan – movement in number of options outstanding

	2006 Number of options (millions)	2006 Weighted average exercise price (USD)	2005 Number of options (millions)	2005 Weighted average exercise price (USD)
Outstanding at 1 January	83	46.64	94	32.32
Granted	17	79.85	20	84.01
Forfeited	(3)	62.09	(2)	42.16
Exercised	(9)	30.42	(29)	25.88
Expired	–	–	–	–
Outstanding at 31 December	88	54.53	83	46.64
– of which exercisable	47	38.48	37	29.39

Genentech Stock Option Plan – terms of options outstanding at 31 December 2006

Range of exercise prices (USD)	Options outstanding: 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	0.4	5.04	7.62	0.4	7.62
10.00–14.35	11.2	4.86	13.68	11.2	13.68
15.04–22.39	7.8	4.34	20.85	7.8	20.86
22.88–33.00	0.2	4.49	26.52	0.2	26.52
35.63–53.23	32.5	6.77	46.85	21.5	45.45
53.95–75.90	1.4	7.79	59.23	0.7	58.39
78.99–98.80	34.8	9.20	82.94	5.6	85.99
Total	88.3	7.27	54.54	47.4	38.48

Chugai Stock Acquisition Rights: During 2003 Chugai adopted a Stock Acquisition Rights programme. The programme allows for the granting of rights to employees and directors of Chugai. Each right entitles the holder to purchase 100 Chugai shares at a specified exercise price. The options, which are non-tradable equity-settled awards, have a ten-year duration and vest after two years.

Chugai Stock Acquisition Rights – movement in number of rights outstanding

	2006 Number of options	2006 Weighted average exercise price (JPY)	2005 Number of options	2005 Weighted average exercise price (JPY)
Outstanding at 1 January	6,800	160,166	4,630	156,474
Granted	3,440	224,500	2,520	164,900
Forfeited	–	–	–	–
Exercised	(354)	149,770	(350)	145,400
Expired	–	–	–	–
Outstanding at 31 December	9,886	182,925	6,800	160,166
– of which exercisable	3,926	158,066	1,960	145,400

Chugai Stock Acquisition Rights – terms of rights outstanding at 31 December 2006

Year of grant	Rights outstanding: Number outstanding	Rights outstanding: Weighted average years remaining contractual life	Rights outstanding: Weighted average exercise price (JPY)	Rights exercisable: Number exercisable	Rights exercisable: Weighted average exercise price (JPY)
2003	1,676	6.50	145,400	1,676	145,400
2004	2,250	7.25	167,500	2,250	167,500
2005	2,520	8.25	164,900	–	–
2006	3,440	9.25	224,500	–	–
Total	9,886	8.07	182,925	3,926	158,066

Issues of share options in 2006: Issues for share options in 2006, including the methodology used to calculate fair value and the main inputs to the valuation models are described below.

Issues of share option plans in 2006

	Roche Option Plan	Genentech Stock Option Plan	Chugai Stock Acquisition Rights
Number of options granted	141 thousand	17 million	3,440
Underlying equity	Roche non-voting equity securities	Genentech common stock	Chugai shares in blocks of 100
Currency	Swiss francs	US dollars	Japanese yen
Vesting period	Progressively over 3 years	Progressively over 4 years	After 2 years
Contractual life	7 years	10 years	10 years
Weighted average fair value of options issued	36.47	24.16	691.36
Option pricing model used	Binomial	Binomial	Binomial
Inputs to option pricing model			
– share price at grant date	195.13	79.85	215,500
– exercise price	195.13	79.85	224,500
– expected volatility	25.60%	27.0%	28.5%
– expected dividend yield	3.17%	0%	1.1%
– early exercise factor	1.483	1.438	n/a
– expected exit rate	10.66%	8.39%	0%

Volatility was determined by reference to historically observed prices of the underlying equity. 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 behaviour. For the Chugai grants in 2006 it was assumed that all awards would be held for the full term length, since there was insufficient historically observed early exercise behaviour.

Other equity compensation plans

Roche Connect: This programme enables all employees worldwide, except for those in the United States and certain other countries, to make regular deductions from their salaries to purchase non-voting equity securities. It is administered by independent third parties. The Group contributes to the programme, which allows the employees to purchase non-voting equity securities at a discount (usually 20%). The administrator purchases the necessary non-voting equity securities directly from the market. At 31 December 2006 the administrator held 911 thousand non-voting equity securities (2005: 713 thousand). The programme has been operational since 1 October 2002. During the year the cost of the plan was 11 million Swiss francs (2005: 9 million Swiss francs), which was reported within the relevant expenditure line by function.

Genentech Employee Stock Purchase Program (ESPP): Genentech has an employee stock purchase programme 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 2006 a total of 1.9 million shares of Genentech common stock were purchased (2005: 1.9 million shares) resulting in a cash inflow of 121 million Swiss francs (2005: 93 million Swiss francs). During the year the cost of the plan was 42 million Swiss francs (2005: 27 million Swiss francs), 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 Group offers Stock-settled Stock Appreciation Rights (S-SARs) to certain directors, management and employees selected at the discretion of the 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 Group covers such obligations by purchasing non-voting equity securities, or derivatives thereon (see Note 31).

Roche S-SARs – movement in number of rights outstanding

	2006		2005	
	Number of rights (thousands)	Weighted average exercise price (CHF)	Number of rights (thousands)	Weighted average exercise price (CHF)
Outstanding at 1 January	3,868	123.34	–	–
Granted	2,762	195.13	3,988	123.33
Forfeited	(151)	149.44	(109)	123.00
Exercised	(596)	126.35	(11)	123.00
Expired	–	–	–	–
Outstanding at 31 December	5,883	156.07	3,868	123.34
– of which exercisable	900	126.49	20	123.00

Roche S-SARs – terms of rights outstanding at 31 December 2006

	Rights outstanding			Rights exercisable	
Year of grant	Number outstanding (thousands)	Weighted average years remaining contractual life	Weighted average exercise price (CHF)	Number exercisable (thousands)	Weighted average exercise price (CHF)
2005	3,201	5.17	123.34	861	123.35
2006	2,682	6.17	195.14	39	195.00
Total	5,883	5.63	156.07	900	126.49

The weighted average fair value of the options granted in 2006 was calculated using a binomial model. The inputs to the model were consistent with those used for the Roche Option Plan 2006 awards given previously. The resulting weighted average fair value per right is CHF 36.45, giving a total fair value of 101 million Swiss francs which is charged over the vesting period of three years.

Roche Performance Share Plan: The Group offers future non-voting equity security awards (or at the Board's discretion, their cash equivalent) to certain directors and key senior managers. The programme was established at the beginning of 2002 and was in effect for three years.

During 2004 the Board approved a new three-year cycle of the Roche Performance Share Plan (PSP) to operate during 2005–2007. The amount of non-voting equity securities allocated will depend upon the individual's salary level, the achievement of performance targets linked to the Group's Total Shareholder Return (shares and non-voting equity securities combined) relative to the Group's peers during the three-year period from the date of the grant, and the discretion of the Board of Directors. For the 2005–2007 cycle a total of 231 thousand awards have been made. 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, being allocated to the recipients in February 2008. The fair value per one unit of PSP from the 2005–2007 cycle is CHF 145.39, giving a total fair value of 34 million Swiss francs which is charged over the vesting period of three years.

During 2005 the Board approved a further three-year cycle of the Roche Performance Share Plan (PSP) to operate during 2006–2008. The terms and conditions are similar to the 2005–2007 cycle. For the 2006–2008 cycle a total of 54 thousand awards have been made. 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, being allocated to the recipients in February 2009. The weighted average fair value of the awards granted in 2006 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 1.93%. The valuation also takes into account the defined rank and performance structure which determines the payout of the PSP. The resulting value per one unit of PSP from the 2006–2008 cycle is CHF 210.06, giving a total fair value of 11 million Swiss francs which is charged over the vesting period of three years.

Roche Stock Appreciation Rights: Some employees of certain North American subsidiaries of the 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 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 Group does not plan to award any further cash-settled SARs and no awards were made in 2005 or 2006.

Roche Stock Appreciation Rights *in millions of CHF*

	2006	2005
Liability at 31 December	199	253
Intrinsic value of vested rights at 31 December	198	243

Roche Stock Appreciation Rights – terms of rights outstanding at 31 December 2006

	Rights outstanding			Rights exercisable	
Year of grant	Number outstanding (thousands)	Expiry	Weighted average exercise price (USD)	Number exercisable (thousands)	Weighted average exercise price (USD)
2001	264	2007	72.60	264	72.60
2002	411	2008	69.35	411	69.35
2003	879	2010	57.65	879	57.65
2004	1,997	2011	104.15	941	104.15
Total	3,551		86.27	2,495	78.70

The fair value at 31 December 2006 was calculated using a binomial model. The inputs to the model were the ADR price at 31 December 2006 (USD 89.45), the exercise prices given in the above table, and other inputs consistent with those used for the Roche Option Plan 2006 awards given previously.

15. Property, plant and equipment

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

	Land	Buildings and land improve-ments	Machinery and equipment	Construction in progress	Total
At 1 January 2005					
Cost	992	7,548	10,943	1,436	20,919
Accumulated depreciation and impairment	–	(2,425)	(6,086)	–	(8,511)
Net book value	992	5,123	4,857	1,436	12,408
Year ended 31 December 2005					
At 1 January 2005	992	5,123	4,857	1,436	12,408
GlycArt acquisition[10]	–	–	3	–	3
Disposal of Consumer Health (OTC) business[11]	–	(7)	(18)	(1)	(26)
Additions	64	519	736	2,109	3,428
Disposals	(18)	(59)	(223)	(3)	(303)
Transfers	29	244	538	(811)	–
Depreciation charge	–	(242)	(1,060)	–	(1,302)
Impairment charge	(4)	(50)	(12)	–	(66)
Currency translation effects	79	424	287	165	955
At 31 December 2005	1,142	5,952	5,108	2,895	15,097
Cost	1,142	9,048	12,654	2,895	25,739
Accumulated depreciation and impairment	–	(3,096)	(7,546)	–	(10,642)
Net book value	1,142	5,952	5,108	2,895	15,097
Year ended 31 December 2006					
At 1 January 2006	1,142	5,952	5,108	2,895	15,097
Additions	46	97	910	2,825	3,878
Disposals	(14)	(95)	(120)	(110)	(339)
Divestment of Genentech España[4]	(4)	(71)	(113)	(4)	(192)
Transfers	–	1,057	1,163	(2,220)	–
Depreciation charge	–	(272)	(1,189)	–	(1,461)
Impairment charge	–	(59)	(12)	–	(71)
Currency translation effects	(44)	(220)	(118)	(113)	(495)
At 31 December 2006	1,126	6,389	5,629	3,273	16,417
Cost	1,126	9,419	13,581	3,273	27,399
Accumulated depreciation and impairment	–	(3,030)	(7,952)	–	(10,982)
Net book value	1,126	6,389	5,629	3,273	16,417

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.

Leasing arrangements where the Group is the lessee

Finance leases: As at 31 December 2006 the capitalised cost of property, plant and equipment under finance leases was 182 million Swiss francs (2005: 199 million Swiss francs) and the net book value of these assets was 79 million Swiss francs (2005: 106 million Swiss francs).

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

	Future minimum lease payments		Present value of future minimum lease payments	
	2006	2005	2006	2005
Within one year	12	13	11	12
Between one and five years	8	19	8	19
More than five years	–	–	–	–
Total	20	32	19	31
Future finance charges	–	–	1	1
Total future minimum lease payments (undiscounted)	20	32	20	32

In addition to the above, Genentech leasing arrangements are disclosed in Note 4.

Operating leases: 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 Group. Total operating lease rental expense was 371 million Swiss francs (2005: 337 million Swiss francs).

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

	2006	2005
Within one year	190	148
Between one and five years	310	223
More than five years	227	118
Total minimum payments	727	489

Leasing arrangements where the 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 recognised 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 CHF*

	Gross investment in lease		Present value of future minimum lease payments	
	2006	2005	2006	2005
Within one year	39	42	32	41
Between one and five years	53	76	45	57
More than five years	1	3	1	2
Total	93	121	78	100
Unearned finance income	(7)	(9)	n/a	n/a
Unguaranteed residual value	n/a	n/a	8	12
Net investment in lease	86	112	86	112

The accumulated allowance for uncollectible minimum lease payments was 0.4 million Swiss francs (2005: 3 million Swiss francs). There were no contingent rents recognised 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 recognised over the lease term on a straight line basis.

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

	2006	2005
Within one year	59	44
Between one and five years	123	86
More than five years	–	1
Total minimum payments	182	131

At 31 December 2006, machinery and equipment with an original cost of 2,192 million Swiss francs (2005: 1,503 million Swiss francs) and a net book value of 832 million Swiss francs (2005: 601 million Swiss francs) was being leased to third parties. There was no contingent rent recognised as income.

Capital commitments

The Group has capital commitments for the purchase or construction of property, plant and equipment totalling 0.6 billion Swiss francs (2005: 0.7 billion Swiss francs). In addition, Genentech's capital commitments in respect of its manufacturing agreements with Lonza and its leasing arrangements are described in Note 4.

16. Goodwill

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

	2006	2005
At 1 January	6,132	5,532
GlycArt acquisition[10]	–	75
Other acquisitions	–	2
Impairment charge	–	–
Currency translation effects	(218)	523
At 31 December	5,914	6,132
Allocated to the following cash-generating units		
Pharmaceuticals Division		
– Roche Pharmaceuticals	75	75
– Genentech	1,681	1,807
– Chugai	113	123
Total Pharmaceuticals Division	1,869	2,005
Diagnostics Division		
– Diabetes Care	768	769
– Centralized Diagnostics	1,216	1,305
– Molecular Diagnostics	–	–
– Near Patient Testing	262	258
– Applied Science	–	–
– Corange/Boehringer Mannheim (held at divisional level and not allocated to business areas)	1,799	1,795
Total Diagnostics Division	4,045	4,127
Total Group	5,914	6,132

There are no accumulated impairment losses in goodwill. The goodwill arising from investments in associated companies is classified as part of the investments in associated companies (see Note 18).

Goodwill impairment testing

Pharmaceuticals Division: The division's reportable business segments are the cash-generating units used for the testing of goodwill. For Genentech and Chugai, the recoverable amount is based on fair value less costs to sell, determined with reference to the publicly quoted share prices of Genentech and Chugai shares. The goodwill in the Roche Pharmaceuticals business is not significant in comparison with the Group's total carrying amount 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 is recorded and monitored at a divisional level as it 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 organisation 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 discount rate used is based on a rate of 7.5%, which is derived from a capital asset pricing model using data from Swiss capital markets, including Swiss Federal Government 10-year bonds and the SMI index. This is then adjusted to a pre-tax rate of 11.4%. 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.

17. Intangible assets

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

	Patents, licences, trademarks and other intangible assets		
	Arising from business combinations	Other	Total
At 1 January 2005			
Cost	11,627	2,685	14,312
Accumulated amortisation and impairment	(6,721)	(1,251)	(7,972)
Net book value	4,906	1,434	6,340
Year ended 31 December 2005			
At 1 January 2005	4,906	1,434	6,340
GlycArt acquisition[10]	198	–	198
Additions	–	262	262
Disposals	–	(2)	(2)
Amortisation charge	(679)	(332)	(1,011)
Impairment charge	–	–	–
Currency translation effects	350	119	469
At 31 December 2005	4,775	1,481	6,256
Cost	12,820	3,112	15,932
Accumulated amortisation and impairment	(8,045)	(1,631)	(9,676)
Net book value	4,775	1,481	6,256

	Patents, licences, trademarks and other intangible assets Arising from business combinations	Other	Total
Year ended 31 December 2006			
At 1 January 2006	4,775	1,481	6,256
Additions	–	593	593
Disposals	(1)	–	(1)
Amortisation charge	(642)	(335)	(977)
Impairment charge	(173)	(24)	(197)
Currency translation effects	(144)	(61)	(205)
At 31 December 2006	3,815	1,654	5,469
Cost	11,708	3,425	15,133
Accumulated amortisation and impairment	(7,893)	(1,771)	(9,664)
Net book value	3,815	1,654	5,469

	2006	2005
Allocated to the following business segments		
– Roche Pharmaceuticals	1,379	1,428
– Genentech	738	789
– Chugai	519	637
– Diagnostics	2,833	3,402
Total Group	5,469	6,256

Included in the Roche Pharmaceuticals business segment are intangible assets with a carrying value of 393 million Swiss francs and a remaining amortisation period of 1–2 years that relate to the purchase by the Group of the global rights to Kytril (granisetron). The Diagnostics business segment includes intangible assets with a carrying value of 1,744 million Swiss francs and a remaining amortisation period of 11 years that relate to the acquisition of Corange/Boehringer Mannheim and intangible assets with a carrying value of 567 million Swiss francs and a remaining amortisation period of 10 years that relate to the acquisition of Igen. Intangible assets that are not yet available for use, which mostly arise from the Group's in-licensing arrangements, total 778 million Swiss francs. Of this total, 632 million Swiss francs relate to the Roche Pharmaceuticals business segment. The Group currently has no internally generated intangible assets from development as the criteria for the recognition as an asset are not met. 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 capitalised rights could result in shortened useful lives or impairment.

In the second half of 2006 the Group recorded impairment charges of 184 million Swiss francs relating to intangible assets in the Diagnostics Division. These followed the regular updating of the division's business plans and technology assessments in the second half of 2006, which indicated anticipated recoverable amounts that were below the current carrying values for certain assets. These mainly concern certain of the intangible assets recorded following the Disetronic acquisition in 2003. These assets were written down to their recoverable amount, based on a value in use calculation using a discount rate of 10.0%. Additionally the remaining useful life of these assets was reassessed and has been reduced from 6.3 years to 3 years, effective 31 December 2006. Consequent to these matters, the Group expects that the 2007 amortisation charge for intangible assets in the Diagnostics Division will be approximately 20 million Swiss francs lower than it would otherwise have been.

In the Roche Pharmaceuticals business segment an impairment charge of 13 million Swiss francs was recorded in the second half of 2006, which relates to a decision to terminate development of one compound with an alliance partner. The asset concerned, which was not yet being amortised, was fully written-down by this charge.

18. Associated companies

The Group's investments in associated companies are accounted for using the equity method. The goodwill arising from investments in associated companies is classified as part of the investments in associated companies.

Investments in associated companies *in millions of CHF*

	Share of net income		Balance sheet value	
	2006	2005	2006	2005
Total investments in associated companies	2	1	7	58

The Group has no significant investments in associated companies and there were no material transactions between the Group and its associated companies. Additional information about associated companies is given in Note 37.

19. Financial and other long-term assets

Financial and other long-term assets *in millions of CHF*

	2006	2005
Available-for-sale investments	803	829
Held-to-maturity investments	25	22
Loans receivable	25	24
Long-term trade receivables	108	210
Restricted cash	1,191	1,105
Total financial long-term assets	2,152	2,190
Prepaid employee benefits	197	202
Reimbursement rights for other post-employment benefit plans[13]	116	122
Other	481	336
Total other long-term assets	794	660

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 the Group's strategic alliance efforts. The carrying value of equity investments held at cost is 27 million Swiss francs (2005: 24 million Swiss francs). The average effective interest rate of held-to-maturity investments is 4.7% (2005: 3.7%). Loans receivable comprise all loans to third parties with a term of over one year. Restricted cash primarily consists of the surety bond posted by Genentech in connection with the City of Hope litigation (see Note 7). As at 31 December 2006 this was 963 million Swiss francs (2005: 966 million Swiss francs).

20. Inventories

Inventories *in millions of CHF*

	2006	2005
Raw materials and supplies	551	606
Work in process	1,056	716
Finished goods and intermediates	4,141	3,860
Less: provision for slow-moving and obsolete inventory	(156)	(141)
Total inventories	5,592	5,041

In 2006 expenses relating to inventories expensed through cost of sales totalled 8,318 million Swiss francs. In 2005 expenses relating to inventories totalled 7,669 million Swiss francs of which 7,636 million Swiss francs were expensed through cost of sales and 33 million Swiss francs relating to the Consumer Health (OTC) business were expensed through profit from discontinued businesses.

21. Accounts receivable

Accounts receivable *in millions of CHF*

	2006	2005
Trade accounts receivable	8,993	7,781
Notes receivable	157	146
Less: allowances	(190)	(229)
Total accounts receivable	8,960	7,698

At 31 December 2006 accounts receivable include amounts denominated in US dollars equivalent to 2.8 billion Swiss francs (2005: 2.3 billion Swiss francs) and amounts denominated in euros equivalent to 3.5 billion Swiss francs (2005: 3.0 billion Swiss francs).

Following the recovery of previously provided amounts, the Group recorded net income from bad debts of 3 million Swiss francs. Net bad debt expense in 2005 was 8 million Swiss francs. Significant concentrations within trade receivables of counterparty credit risk are described in Note 2.

22. Other current assets

Other current assets *in millions of CHF*

	2006	2005
Accrued interest income	36	84
Prepaid expenses	343	291
Derivative financial instruments[27]	80	197
Restricted cash	–	–
Other receivables	1,295	1,131
Total other current assets	1,754	1,703

23. Marketable securities

Marketable securities *in millions of CHF*

	2006	2005
Financial assets at fair-value-through-profit-or-loss		
Held-for-trading investments		
– bonds and debentures	783	802
Designated as fair-value-through-profit-or-loss		
– bonds and debentures	82	78
– other investments	62	–
Total financial assets at fair-value-through-profit-or-loss	927	880
Available-for-sale financial assets		
– shares	876	828
– bonds and debentures	6,533	4,274
– money market instruments and time accounts over three months	12,785	10,675
Total available-for-sale financial assets	20,194	15,777
Total marketable securities	21,121	16,657

Marketable securities are held for fund management purposes and are classified as current. They are primarily denominated in Swiss francs, euros, US dollars and pounds sterling. Other investments held for strategic purposes are classified as non-current (see Note 19).

Shares: These consist primarily of readily saleable equity securities.

Bonds and debentures *in millions of CHF*

Contracted maturity	2006 Amount	2006 Average effective interest rate	2005 Amount	2005 Average effective interest rate
Within one year	2,087	4.32%	1,734	3.56%
Between one and five years	4,552	4.55%	2,933	3.66%
More than five years	759	4.33%	487	3.88%
Total bonds and debentures	7,398	4.46%	5,154	3.65%

Money market instruments: These generally have fixed interest rates ranging from 0.34% to 5.56% (2005: 0.02% to 5.04%) depending upon the currency in which they are denominated. They are contracted to mature within one year of 31 December 2006.

24. Cash and cash equivalents

Cash and cash equivalents *in millions of CHF*

	2006	2005
Cash		
– cash in hand and in current or call accounts	1,662	2,191
Cash equivalents		
– time accounts with a maturity of three months or less	1,548	2,037
Total cash and cash equivalents	3,210	4,228

Restricted cash is included within financial and other long-term assets (see Note 19) or other current assets (see Note 22).

25. Accounts payable

Accounts payable *in millions of CHF*

	2006	2005
Trade accounts payable	1,399	1,371
Other taxes payable	442	450
Other accounts payable	372	552
Total accounts payable	2,213	2,373

26. Accrued and other current liabilities

Accrued and other current liabilities *in millions of CHF*

	2006	2005
Deferred income	144	175
Accrued payroll and related items	1,487	1,282
Interest payable	118	146
Derivative financial instruments[27]	62	142
Other accrued liabilities	3,834	3,382
Total accrued and other current liabilities	5,645	5,127

27. Derivative financial instruments

In appropriate circumstances the Group uses derivative financial instruments as part of its risk management and trading strategies. This is discussed in Note 2. 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 CHF*

	Assets 2006	Assets 2005	Liabilities 2006	Liabilities 2005
Foreign currency derivatives				
– forward exchange contracts and swaps	9	24	(42)	(95)
– other	2	57	(5)	(1)
Interest rate derivatives				
– swaps	1	5	(13)	(26)
– other	–	–	(1)	–
Other derivatives	68	111	(1)	(20)
Total derivative financial instruments[22, 26]	80	197	(62)	(142)

Hedge accounting

The 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 2, the 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 Group generally limits the use of hedge accounting to certain significant transactions. Consequently as at 31 December 2006 the 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.

Genentech has hedged some of its fixed-term debt instruments with interest rate swaps. As at 31 December 2006 such instruments, which have been designated and qualify as fair value hedges, are recorded in the balance sheet as a liability with a fair value of 13 million Swiss francs (2005: liability of 10 million Swiss francs).

Genentech has non-US dollar cash flows from future royalty income and development expenses expected over the next one to five years. To hedge part of this transaction exposure 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 31 December 2006 such instruments, which are designated and qualify for hedge accounting, are recorded as assets with a fair value of 64 million Swiss francs and as liabilities with a fair value of 4 million Swiss francs (2005: assets of 153 million Swiss francs). 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 31.

28. Provisions and contingent liabilities

Provisions: movements in recognised liabilities *in millions of CHF*

	Environmental and legal provisions	Restructuring provisions	Other provisions	Total
Year ended 31 December 2005				
At 1 January 2005	1,198	348	360	1,906
Major legal cases[7]				
– additional provisions created	356	–	–	356
– utilised during the year	(180)	–	–	(180)
Other provisions				
– additional provisions created	39	51	404	494
– unused amounts reversed	(34)	(12)	(27)	(73)
– utilised during the year	(16)	(119)	(294)	(429)
Unwinding of discount[8]	73	4	1	78
Currency translation effects	142	6	80	228
At 31 December 2005	1,578	278	524	2,380
Of which				
– current portion	418	126	289	833
– non-current portion	1,160	152	235	1,547
Total provisions	1,578	278	524	2,380
Year ended 31 December 2006				
At 1 January 2006	1,578	278	524	2,380
Major legal cases[7]				
– additional provisions created	–	–	–	–
– utilised during the year	(31)	–	–	(31)
Other provisions				
– additional provisions created	35	54	588	677
– unused amounts reversed	(29)	(62)	(95)	(186)
– utilised during the year	(13)	(98)	(331)	(442)
Unwinding of discount[8]	66	2	6	74
Currency translation effects	(100)	–	(23)	(123)
At 31 December 2006	1,506	174	669	2,349
Of which				
– current portion	388	79	289	756
– non-current portion	1,118	95	380	1,593
Total provisions	1,506	174	669	2,349
Expected outflow of resources				
– within one year	388	79	289	756
– between one to two years	929	35	135	1,099
– between two to three years	67	20	74	161
– more than three years	122	40	171	333
Total provisions	1,506	174	669	2,349

Environmental and legal provisions

These provisions include 186 million Swiss francs (2005: 212 million Swiss francs) for environmental matters and 1,320 million Swiss francs (2005: 1,366 million Swiss francs) for litigation, including major legal cases and the vitamin case.

Provisions for environmental matters include various separate environmental issues in a number of countries. Approximately half of these were pre-existing in companies acquired by the Group. By their nature the amounts and timing of any outflows are difficult to predict. The Group estimates that approximately half of the amount provided for may result in cash outflows over the next five years. Significant provisions are discounted by between 5% and 6%.

Legal provisions consist mainly of the major legal cases as described in Note 7. The amounts, timing and uncertainties of any outflows are discussed in those notes, as are the discount rates used. The remaining legal provisions, which account for less than 5% of the balance, consist of a number of other separate legal matters in various Group companies. The majority of any cash outflows are expected to occur within the next one to three years, although these are dependent on the development of the various litigations. These provisions are not discounted as the time value of money is not material in these matters.

Restructuring provisions

These arise from planned programmes that materially change the scope of business undertaken by the 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 Group. The remaining amounts are mostly in respect of obligations towards former employees arising from the Pharmaceuticals Division restructuring and other previous restructuring plans. The timings of these cash outflows are reasonably certain on a global basis and are shown in the table above. Significant provisions are discounted by 3%.

Other provisions

Other provisions consist mostly of claims arising from trade, sales returns, certain employee benefit obligations and various other provisions from 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. Significant provisions are discounted by between 4% and 6%.

Contingent liabilities

The operations and earnings of the 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, in the countries in which it operates. The industries in which the 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. See also Note 7 in respect of major legal cases.

The Group has entered into strategic alliances with various companies in order to gain access to potential new products or to utilise other companies to help develop the 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. The Group's best estimate of future commitments for such payments is 334 million Swiss francs in 2007, 160 million Swiss francs in 2008 and 121 million Swiss francs in 2009.

29. Other non-current liabilities

Other non-current liabilities *in millions of CHF*

	2006	2005
Deferred income	163	183
Other long-term liabilities	422	623
Total other non-current liabilities	585	806

30. Debt

Debt: recognised liabilities *in millions of CHF*

	2006	2005
Debt instruments	7,378	8,564
Amounts due to banks and other financial institutions	493	934
Genentech leasing obligations[4]	219	–
Finance lease obligations[15]	19	31
Other borrowings	134	141
Total debt	8,243	9,670
Reported as		
– Long-term debt	6,199	9,322
– Short-term debt	2,044	348
Total debt	8,243	9,670

Debt: repayment terms *in millions of CHF*

	2006	2005
Within one year	2,044	348
Between one and two years	2,207	2,526
Between two and three years	624	2,799
Between three and four years	600	690
Between four and five years	23	645
More than five years	2,745	2,662
Total debt	8,243	9,670

The 'LYONs V' zero coupon US dollar exchangeable notes (see below) are reflected as due the first year that the holders of the notes can request the Group to purchase the notes.

The fair value of the debt instruments is 7.7 billion Swiss francs (2005: 9.2 billion Swiss francs) and the fair value of total debt is 8.6 billion Swiss francs (2005: 10.3 billion Swiss francs). 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 the Group's assets in connection with debt.

Amounts due to banks and other financial institutions

These amounts are denominated in various currencies, notably Canadian dollars, Swiss francs, South African rand and Brazilian real. The average interest rate was 6.1%. The average interest rate in 2005 was 3.0%, when the balance was primarily denominated in euros. Repayment dates are up to four years and 442 million Swiss francs (2005: 224 million Swiss francs) are due within one year.

Debt instruments

Recognised liabilities and effective interest rates of debt instruments *in millions of CHF*

	Effective interest rate	2006	2005
European Medium Term Note programme			
4% bonds due 9 October 2008, principal 750 million euros	4.16%	1,204	1,193
5.375% bonds due 29 August 2023, principal 250 million pounds sterling	5.46%	590	557
3.25% bonds due 2 October 2007, principal 750 million US dollars	3.28%	916	984
Swiss franc bonds			
'Rodeo' 1.75% due 20 March 2008, principal 1 billion Swiss francs	3.00%	992	1,001
US dollar bonds			
'Chameleon' 6.75% due 6 July 2009, principal 487 million US dollars	6.77%	618	681
Zero coupon US dollar exchangeable notes			
'LYONs V' due 25 July 2021, principal 869 million US dollars	4.14%	627	1,528
Genentech Senior Notes			
4.40% Senior Notes due 15 July 2010, principal 500 million US dollars	4.53%	596	644
4.75% Senior Notes due 15 July 2015, principal 1 billion US dollars	4.87%	1,222	1,314
5.25% Senior Notes due 15 July 2035, principal 500 million US dollars	5.39%	611	657
Japanese yen convertible bonds issued by Chugai			
'Series 6 Chugai Pharmaceutical Unsecured Convertible Bonds' 1.05% due 30 September 2008, principal amount of 151 million Japanese yen (0.45 billion Japanese yen in 2005)	1.05%	2	5
Total debt instruments		7,378	8,564

Unamortised discount included in carrying value of debt instruments *in millions of CHF*

	2006	2005
US dollar bonds	–	1
Sterling bonds	9	9
Zero coupon US dollar exchangeable notes	434	1,166
Total unamortised discount	443	1,176

Fair Value Option

In 2005 the Group applied the Fair Value Option on three of its outstanding debt instruments on which the Group had been applying fair value hedge accounting in the past. These debt instruments are the 'European Medium Term Note programme' Euro bonds, the 'Chameleon' US dollar bonds and the 'Rodeo' Swiss franc bonds. The Fair Value Option treatment is based on the elimination of an accounting mismatch which had been recognised between the hedging swaps (reported at fair value) and the hedged bonds (reported at amortised cost). The difference between the carrying value and the principal amount for these debt instruments totals 14 million Swiss francs (2005: 68 million Swiss francs).

Issues of new debt instruments

On 18 July 2005 Genentech completed a private placement of 2 billion US dollars aggregate principal amount of Senior Notes. The placement consisted of 500 million US dollars of 4.40% Senior Notes due 2010, 1 billion US dollars of 4.75% Senior Notes due 2015 and 500 million US dollars of 5.25% Senior Notes due 2035. The Senior Notes contain certain restrictive covenants on incurring property liens and entering into sale and leaseback transactions.

Cash inflows from issues of new debt instruments *in millions of CHF*

	2006	2005
Genentech Senior Notes		
4.40% Senior Notes issued 18 July 2005	–	643
4.75% Senior Notes issued 18 July 2005	–	1,284
5.25% Senior Notes issued 18 July 2005	–	638
Total cash inflows for new issues during the year	–	2,565

Repayments, redemptions and conversions of debt instruments – 2006

Partial conversion of 'LYONs V' US dollar exchangeable notes: During 2006 notes with a carrying value of 680 million US dollars (853 million Swiss francs) were converted into 6.3 million non-voting equity securities. The notes called for conversion during 2006 represent 58% of the number of notes outstanding at the start of the year. A total of 354 million Swiss francs were recorded to equity, which consists of the 1,264 million Swiss francs of cash used to purchase the non-voting equity securities used in the conversion, less the 853 million Swiss francs carrying value of the converted bonds and the related tax effects of 57 million Swiss francs.

Partial conversion of 'Series 6 Chugai Pharmaceutical Unsecured Convertible Bonds': During 2006 bonds with a face value of 0.3 billion Japanese yen (3 million Swiss francs) were converted to shares of Chugai. The Group's percentage ownership of Chugai was unaffected by this conversion, as the Group has bonds convertible into Chugai shares that mirror those that Chugai has outstanding with third parties.

Repayments, redemptions and conversions of debt instruments – 2005

Redemption of 'Sumo' Japanese yen exchangeable bonds: On the due date of 25 March 2005 the Group redeemed these bonds at the original issue amount plus accrued original issue discount (OID). The effective interest rate of these bonds was 1.89%. The cash outflow was 1,178 million Swiss francs. There was no gain or loss recorded on the redemption.

Partial conversion and repurchase of 'LYONs V' US dollar exchangeable notes: On 25 January 2005 the Group repurchased at the option of the bondholders a total of 0.7 million US dollars nominal value of notes for a total consideration of 0.4 million US dollars (0.4 million Swiss francs) which was equal to the carrying value of these notes. During 2005 notes with a carrying value of 0.1 million Swiss francs were converted into 1,066 non-voting equity securities. The notes repurchased and called for conversion during 2005 represented 0.04% of the number of notes outstanding at the start of the year. This had no material impact on the financial statements.

Partial conversion of 'Series 6 Chugai Pharmaceutical Unsecured Convertible Bonds': During 2005 bonds with a face value of 1.4 billion Japanese yen (16 million Swiss francs) were converted to shares of Chugai. The Group's percentage ownership of Chugai was unaffected by this conversion, as the Group has bonds convertible into Chugai shares that mirror those that Chugai has outstanding with third parties.

Cash outflows from repayments and redemptions of debt instruments *in millions of CHF*

	2006	2005
'LYONs V' US dollar exchangeable notes	(1,264)	–
'Sumo' Japanese yen exchangeable bonds	–	(1,178)
Total cash outflows from repayments and redemptions during the year	(1,264)	(1,178)

Terms of outstanding convertible debt instruments

'LYONs V': The notes are exchangeable for Non-voting Equity Securities (NES) or American Depositary Shares (ADS) at an exchange ratio of 5.33901 NES or 10.67802 exchange ADSs per USD 1,000 principal amount at maturity of the notes. The Group will purchase any note for cash, at the option of the holder, on 25 July 2007, 25 July 2011 and 25 July 2016 for a purchase price per USD 1,000 principal amount of the notes of USD 604.74, USD 698.20 and USD 835.58, respectively. In addition, the notes will be redeemable at the option of the Group in whole or in part at any time after 25 July 2007 at the issue price plus accrued original issue discount (OID). If the notes outstanding at 31 December 2006 were all exchanged it would require 4.6 million non-voting equity securities to meet the obligation.

'Series 6 Chugai Pharmaceutical Unsecured Convertible Bonds': Each bond of JPY 1,000,000 par value is convertible into 1,311 shares of Chugai. Conversion is at the option of the bondholder and may be made at any time up to 29 September 2008. The bonds will be redeemable at maturity on 30 September 2008 at the issue price. If the bonds outstanding at 31 December 2006 were all converted it would require 198 thousand Chugai shares to meet the obligation. The Group's percentage ownership in Chugai would not be affected by any conversion, as the Group has bonds convertible into Chugai shares that mirror those that Chugai has outstanding with third parties.

31. Equity attributable to Roche shareholders

Changes in equity attributable to Roche shareholders *in millions of CHF*

Year ended 31 December 2005	Share capital	Own equity instruments	Retained earnings	Fair value reserve	Hedging reserve	Translation reserve	Total
At 1 January 2005 – restated[1]	160	(4,326)	34,703	344	(18)	(4,122)	26,741
Available-for-sale investments							
– Valuation gains (losses) taken to equity	–	–	–	(77)	–	–	(77)
– Transferred to income statement on sale or impairment	–	–	–	(73)	–	–	(73)
Cash flow hedges							
– Gains (losses) taken to equity	–	–	–	–	178	–	178
– Transferred to income statement	–	–	–	–	–	–	–
– Transferred to the initial balance sheet carrying value of hedged items	–	–	–	–	–	–	–
Exchange differences on translation of foreign operations	–	–	–	30	(1)	2,347	2,376
Defined benefit plans							
– Actuarial gains (losses)[13]	–	–	(552)	–	–	–	(552)
– Limit on asset recognition[13]	–	–	–	–	–	–	–
Income taxes on items taken directly to or transferred from equity	–	–	212	91	(72)	–	231
Minority interests	–	–	(8)	60	(47)	(605)	(600)
Net income recognised directly in equity	–	–	(348)	31	58	1,742	1,483
Net income recognised in income statement	–	–	5,923	–	–	–	5,923
Total recognised income and expense	–	–	5,575	31	58	1,742	7,406
Dividends paid	–	–	(1,721)	–	–	–	(1,721)
Transactions in own equity instruments	–	841	–	–	–	–	841
Equity compensation plans	–	–	1,494	–	–	–	1,494
Genentech share repurchases[4]	–	–	(1,398)	–	–	–	(1,398)
Convertible debt instruments	–	–	–	–	–	–	–
Changes in minority interests	–	–	(29)	–	–	–	(29)
At 31 December 2005	160	(3,485)	38,624	375	40	(2,380)	33,334

Year ended 31 December 2006	Share capital	Own equity instru-ments	Retained earnings	Fair value reserve	Hedging reserve	Translation reserve	Total
At 1 January 2006	160	(3,485)	38,624	375	40	(2,380)	33,334
Available-for-sale investments							
– Valuation gains (losses) taken to equity	–	–	–	292	–	–	292
– Transferred to income statement on sale or impairment	–	–	–	(184)	–	–	(184)
Cash flow hedges							
– Gains (losses) taken to equity	–	–	–	–	(71)	–	(71)
– Transferred to income statement	–	–	–	–	–	–	–
– Transferred to the initial balance sheet carrying value of hedged items	–	–	–	–	–	–	–
Exchange differences on translation of foreign operations	–	–	–	(17)	(1)	(1,469)	(1,487)
Defined benefit plans							
– Actuarial gains (losses)[13]	–	–	761	–	–	–	761
– Limit on asset recognition[13]	–	–	(396)	–	–	–	(396)
Income taxes on items taken directly to or transferred from equity	–	–	(149)	(15)	29	–	(135)
Minority interests	–	–	2	8	18	510	538
Net income recognised directly in equity	–	–	218	84	(25)	(959)	(682)
Net income recognised in income statement	–	–	7,880	–	–	–	7,880
Total recognised income and expense	–	–	8,098	84	(25)	(959)	7,198
Dividends paid	–	–	(2,152)	–	–	–	(2,152)
Transactions in own equity instruments	–	1,383	–	–	–	–	1,383
Equity compensation plans	–	–	726	–	–	–	726
Genentech share repurchases[4]	–	–	(696)	–	–	–	(696)
Convertible debt instruments[30]	–	–	(354)	–	–	–	(354)
Changes in minority interests	–	–	5	–	–	–	5
At 31 December 2006	160	(2,102)	44,251	459	15	(3,339)	39,444

Share capital

As of 31 December 2006, the share capital of Roche Holding Ltd, which is the Group's parent company, consisted of 160,000,000 shares with a nominal value of 1.00 Swiss franc each, as in the preceding year. The shares are bearer shares and the Group does not maintain a register of shareholders. Based on information supplied to the Group, a shareholder group with pooled voting rights owns 50.0125% (2005: 50.0125%) of the issued shares. This is further described in Note 34. Based on information supplied to the Group, Novartis International Ltd, Basel, and its affiliates own 33.3330% (participation below 33⅓%) of the issued shares (2005: 33.3330%).

Non-voting equity securities *(Genussscheine)*

As of 31 December 2006, 702,562,700 non-voting equity securities were in issue as in the preceding year. Under Swiss company law these non-voting equity securities have no nominal value, are not part of the share capital and cannot be issued against a contribution which would be shown as an asset in the balance sheet of Roche Holding Ltd. Each non-voting equity security confers the same rights as any of the shares to participate in the net profit and any remaining proceeds from liquidation following repayment of the nominal value of the shares and, if any, participation certificates. In accordance with the law and the Articles of Incorporation of Roche Holding Ltd, the Company is entitled at all times to exchange all or some of the non-voting equity securities into shares or participation certificates.

Dividends

On 27 February 2006 the shareholders approved the distribution of a dividend of CHF 2.50 per share and non-voting equity security (2005: CHF 2.00) in respect of the 2005 business year. The distribution to holders of outstanding shares and non-voting equity securities totalled 2,152 million Swiss francs (2005: 1,721 million Swiss francs) and has been recorded against retained earnings in 2005. The Board has proposed dividends for the 2006 business year of 3.40 Swiss francs per share and non-voting equity security. This is subject to approval at the Annual General Meeting on 5 March 2007.

Own equity instruments

Holdings of own equity instruments *in equivalent number of non-voting equity securities*

	31 December 2006 (millions)	31 December 2005 (millions)
Non-voting equity securities	0.2	–
Low Exercise Price Options	6.8	14.3
Derivative instruments	8.2	7.2
Total own equity instruments	15.2	21.5

Own equity instruments are recorded within equity at original purchase cost. Details of own equity instruments held at 31 December 2006 are shown in the table below. Fair values are disclosed for information purposes.

Own equity instruments at 31 December 2006: supplementary information

	Equivalent number of non-voting equity securities (millions)	Maturity	Strike price (CHF)	Market value (millions of CHF)
Non-voting equity securities	0.2	n/a	n/a	45
Low Exercise Price Options	6.8	24 Jan. 2007–30 Nov. 2007	1.25–8.30	1,454
Derivative instruments	8.2	2 Feb. 2009–1 Feb. 2013	123.00–195.00	699
Total	15.2			2,198

Non-voting equity securities and Low Exercise Price Options are mainly held for the potential conversion obligations that may arise from the Group's convertible debt instruments (see Note 30). The Group's potential obligations to employees for the Roche Option Plan and Roche Stock-settled Stock Appreciation Rights (see Note 14) are covered by call options that are exercisable at any time up to their maturity. The Group also holds a residual number of options that were purchased for use in the Group's previous option compensation scheme, which is now closed.

Following from the conversion in 2006 of 58% of the convertible debt instruments outstanding at the start of the year (see Note 30), the Group reduced its holdings in own equity instruments during the year. The net cash inflow from transactions in own equity instruments was 1,367 million Swiss francs (2005: net cash inflow of 779 million Swiss francs).

The Group holds none of its own 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 of.

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.

Translation reserve: The translation reserve represents the cumulative currency translation differences relating to the consolidation of Group companies that use functional currencies other than Swiss francs.

32. Earnings per share and non-voting equity security

Basic earnings per share and non-voting equity security

For the calculation of basic earnings per share and non-voting equity security, the number of shares and non-voting equity securities is reduced by the weighted average number of its own non-voting equity securities held by the Group during the period.

Basic earnings per share and non-voting equity security

	Continuing businesses 2006	2005	Group 2006	2005
Net income (millions of CHF)	7,860	5,935	7,880	5,923
Number of shares (millions)[31]	160	160	160	160
Number of non-voting equity securities (millions)[31]	703	703	703	703
Weighted average number of own non-voting equity securities held (millions)	(11)	(18)	(11)	(18)
Weighted average number of shares and non-voting equity securities in issue used to calculate basic earnings per share (millions)	852	845	852	845
Basic earnings per share and non-voting equity security (CHF)	9.22	7.02	9.24	7.01

Diluted earnings per share and non-voting equity security

For the calculation of diluted earnings per share and non-voting equity security, the net income and weighted average number of shares and non-voting equity securities outstanding are adjusted for the effects of all dilutive potential shares and non-voting equity securities.

Potential dilutive effects arise from the convertible debt instruments and the employee stock option plans. If the outstanding convertible debt instruments were to be converted then this would lead to a reduction in interest expense and an increase in the number of shares which may have a net dilutive effect on the earnings per share. The exercise of outstanding vested employee stock options would have a dilutive effect. The exercise of the outstanding vested Genentech employee stock options would have a dilutive effect if the net income of Genentech is positive. The diluted earnings per share and non-voting equity security reflects the potential impacts of these dilutive effects on the earnings per share figures.

Diluted earnings per share and non-voting equity security

	Continuing businesses 2006	2005	Group 2006	2005
Net income (millions of CHF)	7,860	5,935	7,880	5,923
Elimination of interest expense, net of tax, of convertible debt instruments, where dilutive (millions of CHF)	25	43	25	43
Increase in minority share of Group net income, net of tax, assuming all outstanding Genentech stock options exercised (millions of CHF)	(100)	(58)	(100)	(58)
Net income used to calculate diluted earnings per share (millions of CHF)	7,785	5,920	7,805	5,908
Weighted average number of shares and non-voting equity securities in issue (millions)	852	845	852	845
Adjustment for assumed conversion of convertible debt instruments, where dilutive (millions)	7	13	7	13
Adjustment for assumed exercise of equity compensation plans, where dilutive (millions)	3	2	3	2
Weighted average number of shares and non-voting equity securities in issue used to calculate diluted earnings per share (millions)	862	860	862	860
Diluted earnings per share and non-voting equity security (CHF)	9.03	6.89	9.05	6.87

33. Minority interests

Changes in equity attributable to minority interests *in millions of CHF*

	2006	2005
At 1 January – restated[1]	6,824	5,280
Net income recognised directly in equity	(538)	600
Net income recognised in income statement		
– Genentech[4]	1,077	616
– Chugai[5]	202	318
– Other minority interests	12	9
Total net income recognised in income statement	1,291	943
Total recognised income and expense	753	1,543
Dividends paid to minority shareholders[5]	(105)	(68)
Equity compensation plans	450	1,131
Genentech share repurchases[4]	(552)	(1,113)
Convertible debt instruments	5	22
Changes in minority interests	(5)	29
At 31 December	7,370	6,824
Of which		
– Genentech[4]	5,250	4,658
– Chugai[5]	2,088	2,139
– Other minority interests	32	27
Total minority interests	7,370	6,824

34. Related parties

Controlling shareholders

The share capital of Roche Holding Ltd, which is the Group's parent company, consists of 160,000,000 bearer shares. Based on information supplied by a shareholder group with pooled voting rights, comprising Ms Vera Michalski-Hoffmann, Ms Maja Hoffmann, Mr André Hoffmann, Dr Andreas Oeri, Ms Sabine Duschmalé-Oeri, Ms Catherine Oeri, Ms Beatrice Oeri and Ms Maja Oeri, that group holds 80,020,000 shares as in the preceding year, which represents 50.0125% of the issued shares. This figure does not include any shares without pooled voting rights that are held outside this group by individual members of the group.

Mr André Hoffmann and Dr Andreas Oeri are members of the Board of Directors of Roche Holding Ltd and in this capacity each receive an annual remuneration of 300,000 Swiss francs. Since 28 February 2006, Mr Hoffmann is a Vice-Chairman of the Board, and in 2006 he received a further 83,333 Swiss francs in this capacity. Dr Oeri is Chairman of the Corporate Governance and Sustainability Committee and receives 10,000 Swiss francs for his time and expenses in this capacity.

There were no other transactions between the Group and the individual members of the above shareholder group.

Subsidiaries and associated companies

A listing of the major Group subsidiaries and associated companies is included in Note 37. Transactions between the parent company and its subsidiaries and between subsidiaries are eliminated on consolidation. There were no significant transactions between the Group and its associated companies.

Key management personnel

Members of the Board of Directors of Roche Holding Ltd receive an annual remuneration and payment for their time and expenses related to their membership of Board committees.

Remuneration of members of the Board of Directors in 2006 *in CHF*

	Annual remuneration	Compensation for Board committee members	Total
Executive director			
F. B. Humer	300,000	–	300,000
Non-executive directors			
B. Gehrig	450,000	–	450,000
R. Hänggi (until 27 February 2006)	66,667	–	66,667
A. Hoffmann	383,333	–	383,333
J. I. Bell	300,000	10,000	310,000
P. Brabeck-Letmathe	300,000	–	300,000
L. J. R. de Vink	300,000	10,000	310,000
W. Frey	300,000	20,000	320,000
D. A. Julius	300,000	10,000	310,000
A. Oeri	300,000	10,000	310,000
H. Teltschik	300,000	20,000	320,000
B. Weder di Mauro (from 28 February 2006)	250,000	20,000	270,000
Total non-executive directors	3,250,000	100,000	3,350,000
Total remuneration of Board of Directors	3,550,000	100,000	3,650,000

Remuneration to Prof. Gehrig includes serving as Independent Lead Director and Vice-Chairman of the Board. Remuneration to Mr Hänggi includes serving as Vice-Chairman of the Board until 27 February 2006. Remuneration to Mr Hoffmann includes serving as Vice-Chairman of the Board from 28 February 2006. Remuneration of non-executive members of the Board of Directors in 2005 totalled 3 million Swiss francs.

Prof. Bell has been on a one-year sabbatical leave from the University of Oxford since August 2006 and is spending the year at Roche. Roche will pay all personal and family expenses that Prof. Bell incurs in relation to his stay in Switzerland, including insurance costs. In 2006 these expenses totalled 67,909 Swiss francs. In addition Roche paid 122,719 Swiss francs into a retirement policy for Prof. Bell in 2006. Prof. Teltschik received honoraria, including expenses, amounting to 25,132 euros (39,457 Swiss francs) for serving on the boards of several Roche subsidiaries in Germany. Otherwise, no additional remuneration was paid to members of the Board of Directors.

In 2005 in connection with the acquisition of GlycArt on 25 July 2005 (see Note 10), the Group paid Mr Hänggi 1,731,248 Swiss francs in consideration for his shareholding in GlycArt. This was equivalent to the amounts paid to other shareholders of GlycArt for the purchase of their shareholdings.

Members of the Corporate Executive Committee of Roche Holding Ltd receive remuneration, indirect benefits and participate in certain equity compensation plans.

Remuneration of members of the Executive Committee in 2006 *in CHF*

	Annual salary	Bonus	Expense allowance	Total
F.B. Humer	6,030,000	1,500,000	50,000	7,580,000
W.M. Burns	1,875,000	1,000,000	30,000	2,905,000
E. Hunziker	1,900,000	1,000,000	30,000	2,930,000
G.A. Keller	850,000	400,000	30,000	1,280,000
J.K.C. Knowles	1,325,000	670,000	30,000	2,025,000
S. Schwan	762,500	95,000	30,000	887,500
Total	12,742,500	4,665,000	200,000	17,607,500

The annual salary amount for Dr Humer includes the 300,000 Swiss francs that he receives in his capacity as a member of the Board of Directors as described above. Remuneration of members of the Executive Committee in 2005 totalled 17 million Swiss francs.

Dr Humer, Dr Hunziker, Mr Burns and Prof. Knowles received in total 193,104 US dollars (241,380 Swiss francs) for serving on the Chugai Board. Dr Hunziker, Mr Burns and Prof. Knowles are also on the Genentech Board but have declined remuneration for serving in this capacity.

Mr H. von Prondzynski stepped down from the Executive Committee on 31 December 2005. During 2006 he assisted with the transition to his successor and he resigned from Roche effective 31 December 2006. In 2006 he was paid a salary of 1,300,000 Swiss francs. He received a bonus of 700,000 Swiss francs in respect of 2005 and an expense allowance of 30,000 Swiss francs.

Otherwise, no additional remuneration was paid to current or former members of the Corporate Executive Committee.

The Group pays social insurance contributions in respect of the above remuneration and pays contributions to pension and other post-employment benefits plans for members of the Executive Committee. Members of the Executive Committee may also participate in the Roche Connect employee stock purchase plan (see Note 14).

Indirect benefits (employer contributions) of members of the Executive Committee in 2006 *in CHF*

	Pensions	Social insurance	Roche Connect
F.B. Humer	1,308,585	830,655	50,004
W.M. Burns	715,019	146,255	30,000
E. Hunziker	556,585	147,518	45,832
G.A. Keller	333,976	88,188	20,420
J.K.C. Knowles	886,153	101,815	22,500
S. Schwan	194,949	46,493	18,444
Total	3,995,267	1,360,924	187,200

Owing to amendments to Switzerland's Federal Occupational Old Age, Survivors' and Disability Pension Act (BVG), contributions on behalf of Dr Humer were limited to 1,308,585 Swiss francs. Due to the existing contractual obligations with Dr Humer an additional provision of 1,549,862 Swiss francs was recognised by the Group.

Pension, social insurance and Roche Connect contributions paid by the Group in 2005 totalled 8 million Swiss francs.

In addition in 2006 the Group paid employer contributions of 883,086 Swiss francs (pensions), 206,094 Swiss francs (social insurance) and 27,500 Swiss francs (Roche Connect) in respect of Mr von Prondzynski.

Roche Long-Term: As discussed in Note 14, during 2005 the Group implemented a new global long-term incentive programme which is available to certain directors, management and employees selected at the discretion of the Group. The programme consists of Stock-settled Stock Appreciation Rights (S-SARs) with the Group having the alternative of granting awards under the existing Roche Option Plan (ROP). During 2006 members of the Executive Committee were granted 151,725 S-SARs and no ROP awards (2005: 223,602 S-SARs and no ROP awards). The terms, vesting conditions and fair value of these awards are disclosed in Note 14.

Roche Performance Share Plan: As disclosed in Note 14, the Board approved a three-year cycle of the Roche Performance Share Plan to operate during 2005–2007 and a further three-year cycle to operate during 2006–2008. During 2006 members of the Executive Committee were targeted with 20,161 awards of the 2006–2008 cycle (2005: 91,195 awards from the 2005–2007 cycle). Each award will result in between zero and two non-voting equity securities, depending upon the achievement of the performance targets, being allocated to the recipients in February 2009. The terms, vesting conditions and fair value of these awards are disclosed in Note 14.

Other transactions with members of the Executive Committee: Dr Keller had taken out a mortgage loan of 492,500 Swiss francs with the Pension Fund of F. Hoffmann-La Roche Ltd at an interest rate of 4.2% p.a. Dr Keller repaid this at the end of 2006. In 2006 the Group paid Dr Schwan 45,123 Swiss francs for one-time relocation and housing expenses. Pensions totalling 2,014,352 Swiss francs were paid to two former Executive Committee members.

Post-employment benefit plans
Transactions between the Group and the various post-employment defined benefit plans for the employees of the Group are described in Note 13.

35. Cash flow statement

Cash flows from operating activities

Cash flows from operating activities arise from the Group's primary activities in the Pharmaceuticals and Diagnostics businesses. These are calculated by the indirect method by adjusting the Group's operating profit for any operating income and expenses that are not cash flows (for example depreciation, amortisation 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, including, for example, the taxes paid on the income from bond conversion and redemption.

Cash generated from operations *in millions of CHF*

	2006	2005
Net income	9,171	6,866
Add back non-operating (income) expense		
– Associated companies[18]	(2)	(1)
– Financial income[8]	(1,829)	(1,313)
– Financing costs[8]	974	985
– Income taxes[9]	3,436	2,284
– Discontinued businesses[11]	(20)	12
Operating profit	11,730	8,833
Depreciation of property, plant and equipment[15]	1,461	1,302
Amortisation of intangible assets[17]	977	1,011
Impairment of intangible assets[17]	197	–
Impairment of property, plant and equipment[15]	71	66
Major legal cases[7]	–	356
Operating expenses for defined benefit post-employment plans[13]	348	149
Operating expenses for equity-settled equity compensation plans[14]	620	364
Other adjustments	571	445
Cash generated from continuing businesses	15,975	12,526
Operating cash flows generated from discontinued businesses[11]	–	(5)
Cash generated from operations	15,975	12,521

Cash flows from investing activities

Cash flows from investing activities are principally those arising from the Group's investments in property, plant and equipment and intangible assets, and from the acquisition and divestment of subsidiaries, associated companies and businesses. Cash flows connected with the 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 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 Group's other investments.

Interest and dividends received *in millions of CHF*

	2006	2005
Interest received	836	373
Dividends received	10	10
Total	846	383

Cash flows from financing activities

Cash flows from financing activities are primarily the proceeds from the issue and repayment of the 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 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.

Interest and dividends paid *in millions of CHF*

	2006	2005
Interest paid	(343)	(194)
Dividends paid[31, 33]	(2,257)	(1,789)
Total	(2,600)	(1,983)

Significant non-cash transactions

In 2006 additions to property, plant and equipment of 230 million Swiss francs were recorded from Genentech leasing arrangements (see Note 4) and there was a corresponding increase in long-term debt. There were no significant non-cash transactions in 2005.

36. Subsequent events

There were no significant events after the balance sheet date.

37. Subsidiaries and associated companies

Listed companies

Country	Company	City	Share capital (in mill.)		Equity interest (in %)
Switzerland	Roche Holding Ltd Stock Exchange: SWX Zurich Valor Share: 1203211 Valor *Genussscheine:* 1203204 ISIN Share: CH0012032113 ISIN *Genussscheine:* CH0012032048 Market Capitalisation: CHF 191,575.4 mill.	Basel	CHF	160.0	
	Basilea Pharmaceutica Ltd. Stock Exchange: SWX Bio Zurich, NASDAQ Biotech Valor: 1143244 ISIN: CH0011432447 Market Capitalisation: CHF 1,658.3 mill.	Basel	CHF	7.8	18.1
United States	Genentech, Inc. Stock Exchange: New York ISIN: US3687104063 Market Capitalisation: USD 85,418.4 mill.	South San Francisco (incorporated in Delaware)	USD	21.1	55.8
Japan	Chugai Pharmaceutical Co., Ltd. Stock Exchange: Tokyo ISIN: JP3519400000 Market Capitalisation: JPY 1,360,389.0 mill.	Tokyo	JPY	80.0	50.6

Non-listed companies

Country	Company	City	Share capital (in mill.)		Equity interest (in %)
Argentina	Productos Roche S.A. Química e Industrial	Buenos Aires	ARS	83.0	100
Australia	Roche Diagnostics Australia Pty. Limited	Castle Hill	AUD	5.0	100
	Roche Products Pty. Limited	Dee Why	AUD	65.0	100
Austria	Roche Austria GmbH	Vienna	EUR	14.5	100
	Roche Diagnostics GmbH	Vienna	EUR	1.5	100
	Roche Diagnostics Graz GmbH	Graz	EUR	0.4	100
Belgium	N.V. Roche S.A.	Brussels	EUR	32.0	100
	Roche Diagnostics Belgium S.A.	Brussels	EUR	3.8	100
Bermuda	Canadian Pharmholding Ltd.	Hamilton	USD	(–)	100
	Corange International Ltd.	Hamilton	USD	1.0	100
	Corange Ltd.	Hamilton	USD	38.0	100
	Roche Financial Investments Ltd.	Hamilton	USD	(–)	100
	Roche Financial Services Ltd.	Hamilton	USD	0.1	100
	Roche Interfinance Ltd.	Hamilton	USD	(–)	100
	Roche International Ltd.	Hamilton	USD	(–)	100
	Roche Intertrade Ltd.	Hamilton	USD	10.0	100
	Roche Services Holdings Ltd.	Hamilton	USD	(–)	100
	Syntex Pharmaceuticals International Ltd.	Hamilton	USD	(–)	100
Brazil	Produtos Roche Químicos e Farmacêuticos S.A.	São Paulo	BRL	41.7	100
	Roche Diagnostica Brasil Ltda.	São Paulo	BRL	149.0	100

Country	Company	City	Share capital (in mill.)		Equity interest (in %)
Bulgaria	Roche Bulgaria EOOD	Sofia	BGN	5.1	100
Canada	Chempharm Limited	Toronto	CAD	(–)	100
	Hoffmann-La Roche Limited	Toronto	CAD	15.3	100
	Sapac Corporation Ltd.	St. John	CAD	(–)	100
Chile	Roche Chile Limitada	Santiago de Chile	CLP	70.9	100
China	Roche Diagnostics (Hong Kong) Limited	Hong Kong	HKD	10.0	100
	Roche Diagnostics (Shanghai) Limited	Shanghai	USD	1.0	100
	Roche Hong Kong Limited	Hong Kong	HKD	10.0	100
	Roche R&D Center (China) Ltd.	Shanghai	USD	6.3	100
	Shanghai Roche Pharmaceuticals Limited	Shanghai	USD	19.5	70
Colombia	Productos Roche S.A.	Bogotá	COP	1,923.7	100
Costa Rica	Roche Servicios S.A.	San José	USD	0.1	100
Croatia	Roche D.O.O.	Zagreb	HRK	4.8	100
Czech Republic	Roche s.r.o.	Prague	CZK	200.0	100
Denmark	Proteo Pharma ApS	Copenhagen	DKK	0.1	100
	Roche a/s	Hvidovre	DKK	4.0	100
	Roche Bio Denmark a/s	Copenhagen	DKK	90.2	100
	Roche Diagnostics a/s	Hvidovre	DKK	1.2	100
Dominican Republic	Productos Roche Dominicana S.A.	Santo Domingo	DOP	0.6	100
Ecuador	Roche Ecuador S.A.	Quito	USD	1.1	100
El Salvador	Productos Roche (El Salvador) S.A.	San Salvador	SVC	0.2	100
Estonia	Roche Eesti OÜ	Tallinn	EEK	2.0	100
Finland	Roche Diagnostics Oy	Espoo	EUR	0.2	100
	Roche Oy	Espoo	EUR	(–)	100
France	Cenexi SAS	Fontenay-sous-Bois	EUR	49.1	100
	Roche Diagnostics S.A.	Meylan	EUR	16.0	100
	Roche S.A.S.	Neuilly-sur-Seine	EUR	38.2	100
Germany	Disetronic Medical Systems GmbH	Sulzbach	EUR	(–)	100
	Galenus Mannheim GmbH	Mannheim	EUR	1.7	100
	Roche Deutschland Holding GmbH	Grenzach-Wyhlen	DEM	10.0	100
	Roche Diagnostics GmbH	Mannheim	EUR	94.6	100
	Roche Pharma AG	Grenzach-Wyhlen	EUR	61.4	100
Greece	Roche (Hellas) S.A.	Athens	EUR	19.8	100
	Roche Diagnostics (Hellas) S.A.	Athens	EUR	23.7	100
Guatemala	Productos Roche Guatemala S.A.	Guatemala	GTQ	0.6	100
Honduras	Productos Roche (Honduras), S.A.	Tegucigalpa	HNL	(–)	100
Hungary	Roche (Hungary) Ltd.	Budapest	HUF	30.0	100
	Roche Services (Europe) Ltd.	Budapest	HUF	3.0	100
India	Roche Diagnostics (India) Pvt. Ltd.	Mumbai	INR	20.2	100
	Roche Scientific Company (India) Pvt. Ltd.	Mumbai	INR	10.0	100
Indonesia	P.T. Roche Indonesia	Jakarta	IDR	1,323.0	98.3
Ireland	Roche Ireland Limited	Clarecastle	EUR	1.9	100
	Roche Products (Ireland) Limited	Dublin	EUR	0.2	100
Italy	Roche Diagnostics S.p.A.	Milan	EUR	18.1	100
	Roche S.p.A.	Milan	EUR	34.1	100
Japan	Roche Diagnostics K.K.	Tokyo	JPY	2,500.0	100
Latvia	Roche Latvija SIA	Riga	LVL	0.2	100
Lithuania	UAB Roche Lietuva	Vilnius	LIT	0.7	100
Luxembourg	Pharminvest S.A.	Luxembourg	EUR	28.0	100
Malaysia	Roche (Malaysia) Sdn Bhd.	Kuala Lumpur	MYR	4.0	100
	Roche Diagnostics (Malaysia) Sdn Bhd.	Kuala Lumpur	MYR	0.9	100
Mexico	Grupo Roche Syntex de México, S.A. de C.V.	Mexico City	MXN	3.5	100
	Lakeside de México, S.A. de C.V.	Mexico City	MXN	48.0	100
	Productos Roche S.A. de C.V.	Mexico City	MXN	2.2	100
	Syntex S.A. de C.V.	Mexico City	MXN	80.4	100
Morocco	Roche S.A.	Casablanca	MAD	9.5	45

Country	Company	City	Share capital (in mill.)		Equity interest (in %)
Netherlands	Roche Diagnostics Nederland B.V.	Almere	EUR	2.3	100
	Roche Finance Europe B.V.	Woerden	EUR	2.0	100
	Roche Nederland B.V.	Woerden	EUR	10.9	100
	Roche Pharmholding B.V.	Woerden	EUR	467.8	100
New Zealand	Roche Diagnostics New Zealand Pty. Ltd.	Auckland	NZD	3.0	100
	Roche Products (New Zealand) Limited	Auckland	NZD	13.5	100
Nicaragua	Productos Roche (Nicaragua) S.A.	Managua	NIO	(–)	100
Norway	Roche Diagnostics Norge A/S	Oslo	NOK	5.8	100
	Roche Norge A/S	Oslo	NOK	6.2	100
Pakistan	Roche Pakistan Ltd.	Karachi	PKR	38.3	100
Panama	Productos Roche Interamericana S.A.	Panama City	USD	0.1	100
	Productos Roche Panamá S.A.	Panama City	PAB	(–)	100
	Syntex Corporation	Panama City	USD	1.0	100
	Syntex Puerto Rico Inc.	Panama City	USD	(–)	100
	Technical Development Corp.	Panama City	CHF	0.8	100
Peru	Productos Roche Química Farmacéutica S.A.	Lima	PEN	11.1	100
Philippines	Roche (Philippines) Inc.	Makati	PHP	125.0	100
Poland	Roche Diagnostics Polska Sp. z o.o.	Warsaw	PLN	2.0	100
	Roche Polska Sp. z o.o.	Warsaw	PLN	2.0	100
Portugal	Roche Farmacêutica Química Lda.	Amadora	EUR	1.1	100
	Roche Sistemas de Diagnósticos Sociedade Unipessoal Lda.	Linda-A-Velha	EUR	0.6	100
Romania	Roche Romania S.R.L.	Bucharest	RON	53.4	100
Russia	Roche Moscow Ltd.	Moscow	RUB	2.6	100
Serbia	Roche D.O.O. Beograd	Belgrade	EUR	1.8	100
Singapore	Roche Diagnostics Asia Pacific Pte. Ltd.	Singapore	SGD	7.4	100
	Roche Singapore Pte. Ltd.	Singapore	SGD	4.0	100
Slovakia	Roche Slovensko, S.R.O.	Bratislava	SKK	10.0	100
Slovenia	Roche D.O.O. Pharmaceutical Company	Ljubljana	SIT	46.5	100
South Africa	Roche Products (Proprietary) Limited	Johannesburg	ZAR	55.0	100
South Korea	Roche Diagnostics Korea Co., Ltd.	Seoul	KRW	22,969.0	100
	Roche Korea Company Ltd.	Seoul	KRW	13,375.0	100
Spain	Andreu Roche S.A.	Madrid	EUR	0.1	100
	Roche Diagnostics S.L.	Barcelona	EUR	18.0	100
	Roche Farma S.A.	Madrid	EUR	54.1	100
	Syntex Roche S.A.	Madrid	EUR	0.1	100
Sweden	Roche AB	Stockholm	SEK	20.0	100
	Roche Diagnostics Scandinavia AB	Bromma	SEK	9.0	100
Switzerland	Disetronic Handels AG	Burgdorf	CHF	0.1	100
	Disetronic Holding AG	Burgdorf	CHF	9.7	100
	Disetronic Licensing AG	Burgdorf	CHF	0.1	100
	Disetronic Medical Systems AG	Burgdorf	CHF	0.9	100
	F. Hoffmann-La Roche Ltd	Basel	CHF	150.0	100
	GlycArt Biotechnology Ltd.	Schlieren	CHF	0.3	100
	IMIB Institute for Medical Informatics and Biostatistics Ltd.	Basel	CHF	0.1	100
	Rabbit-Air Ltd.	Zurich-Kloten	CHF	3.0	100
	Roche Diagnostics (Switzerland) Ltd.	Rotkreuz	CHF	1.0	100
	Roche Diagnostics International Ltd.	Steinhausen	CHF	20.0	100
	Roche Finance Ltd.	Basel	CHF	409.2	100
	Roche Instrument Center Ltd.	Rotkreuz	CHF	5.0	100
	Roche Capital Market Ltd.	Basel	CHF	1.0	100
	Roche Pharma (Switzerland) Ltd.	Reinach	CHF	2.0	100
	Syntex Corporation	Basel	CHF	0.2	100
Taiwan	Roche Diagnostics Ltd.	Taipei	TWD	80.0	100
	Roche Products Ltd.	Taipei	TWD	100.0	100
Thailand	Roche Diagnostics (Thailand) Limited	Bangkok	THB	103.0	100
	Roche Thailand Limited	Bangkok	THB	12.0	100
Turkey	Roche Diagnostik Sistemleri Ticaret A.S.	Istanbul	TRY	30.0	100
	Roche Müstahzarlari Sanayi Anonim Sirketi	Istanbul	TRY	121.0	100

Country	Company	City	Share capital (in mill.)		Equity interest (in %)
United Kingdom	Roche Diagnostics Ltd.	Lewes	GBP	32.6	100
	Roche Holding (UK) Limited	Welwyn Garden City	GBP	100.0	100
	Roche Products Limited	Welwyn Garden City	GBP	98.3	100
	Roche Registration Limited	Welwyn Garden City	GBP	(–)	100
United States	Disetronic Medical Systems Inc.	St. Paul	USD	(–)	100
	Hoffmann-La Roche Inc.	Nutley	USD	3.0	100
	Idaho Technology Inc.	Salt Lake City	USD	2.0	20.4
	IGEN International, Inc.	Wilmington	USD	(–)	100
	Roche Carolina Inc.	Florence	USD	(–)	100
	Roche Colorado Corporation	Boulder	USD	(–)	100
	Roche Diagnostics Corporation	Indianapolis	USD	(–)	100
	Roche Finance America Inc.	Wilmington	USD	(–)	100
	Roche Finance USA Inc.	Wilmington	USD	(–)	100
	Roche Holdings, Inc.	Wilmington	USD	1.0	100
	Roche Laboratories Inc.	Nutley	USD	(–)	100
	Roche Molecular Systems, Inc.	Pleasanton	USD	(–)	100
	Roche Palo Alto LLC	Palo Alto	USD	(–)	100
Uruguay	Roche International Ltd. – Montevideo Branch	Montevideo	UYU	(–)	100
	Sapac Corporation Ltd.	Montevideo	UYU	(–)	100
Venezuela	Productos Roche S.A.	Caracas	VEB	200.0	100

(–) = share capital of less than 100,000 local currency units.

Report of the Group Auditors

Report of the Group Auditors to the Annual General Meeting of Roche Holding Ltd, Basel

As group auditors, we have audited the consolidated financial statements (income statement, balance sheet, cash flow statement, statement of recognised income and expense, statement of changes in equity and notes on pages 22 to 96) of Roche Holding Ltd for the year ended 31 December 2006.

These consolidated financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss auditing standards and with the International Standards on Auditing (ISA), which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

KPMG

KPMG Klynveld Peat Marwick Goerdeler SA

John A. Morris
Auditor in charge

Erik F.J. Willems

Basel, 1 February 2007

Multi-Year Overview

Statistics, as reported

	1997[a]	1998	1999
Statement of income *in millions of CHF*			
Sales	18,767	24,662	27,567
EBITDA	5,076	6,423	8,874
Operating profit	3,590	4,350	6,421
Net income attributable to Roche shareholders	(2,031)	4,392	5,764
Research and development	2,903	3,408	3,782
Balance sheet *in millions of CHF*			
Non-current assets	32,453	27,952	35,800
Current assets	22,323	27,927	34,631
Total assets	54,776	55,879	70,431
Non-current liabilities	(21,181)	(21,416)	(25,574)
Current liabilities	(14,158)	(11,648)	(14,856)
Total liabilities	(35,339)	(33,064)	(40,430)
Net assets	19,437	22,815	30,001
Capital and reserves attributable to Roche shareholders	18,250	21,666	26,954
Equity attributable to minority interests	1,187	1,149	3,047
Additions to property, plant and equipment	1,802	1,883	2,150
Personnel			
Number of employees at end of year	51,643	66,707	67,695
Key ratios			
Net income as % of sales	–11	18	21
Net income as % of equity	–11	20	21
Research and development as % of sales	15	14	14
Current ratio %	158	240	233
Equity and minority interests as % of total assets	36	41	43
Sales per employee in thousands of CHF	363	370	407
Data on shares and non-voting equity securities			
Number of shares	1,600,000	1,600,000	1,600,000
Number of non-voting equity securities *(Genussscheine)*	7,025,627	7,025,627	7,025,627
Total shares and non-voting equity securities	8,625,627	8,625,627	8,625,627
Total dividend in millions of CHF	716	750	863[c]
Earnings per share and non-voting equity security (diluted) in CHF	(235)	509	668
Dividend per share and non-voting equity security in CHF	83	87	100[c]
Cash and warrants in addition to dividend in CHF	–	190[b]	–

Information in this table is stated as reported. Changes in accounting policies arising from changes in International Financial Reporting Standards and the 100 for 1 stock split in 2001 are not applied retrospectively.

2000	2001	2002	2003	2004	2005	2006
28,672	29,163	29,453	31,220	31,273	35,511	42,041
11,126	6,438	7,993	8,609	9,566	11,404	14,436
7,131	3,247	1,335	5,592	8,979	8,669	11,730
8,647	3,697	(4,026)	3,069	6,641	5,787	7,880
3,950	3,893	4,257	4,766	5,093	5,705	6,589
34,798	36,411	33,143	29,820	28,670	33,739	33,519
34,737	38,875	30,852	29,666	29,406	35,626	40,895
69,535	75,286	63,995	59,486	58,076	69,365	74,414
(23,642)	(25,772)	(22,850)	(18,658)	(14,882)	(18,130)	(14,908)
(13,857)	(15,647)	(15,372)	(11,664)	(9,901)	(9,492)	(12,692)
(37,499)	(41,419)	(38,222)	(30,322)	(24,783)	(27,622)	(27,600)
32,036	33,867	25,773	29,164	33,293	41,743	46,814
27,608	28,973	20,810	23,570	28,223	34,922	39,444
4,428	4,894	4,963	5,594	5,070	6,821	7,370
2,183	1,931	2,044	2,265	2,357	3,428	3,878
64,758	63,717	69,659	65,357	64,703	68,218	74,372
30	13	–14	10	21	16	19
31	13	–19	13	24	17	20
14	13	14	15	16	16	16
251	248	201	254	297	375	322
46	45	40	49	57	60	63
443	458	427	482	483	521	565
1,600,000	160,000,000	160,000,000	160,000,000	160,000,000	160,000,000	160,000,000
7,025,627	702,562,700	702,562,700	702,562,700	702,562,700	702,562,700	702,562,700
8,625,627	862,562,700	862,562,700	862,562,700	862,562,700	862,562,700	862,562,700
992	1,121	1,251	1,423	1,725	2,156	2,933[d]
1,024	4.37	(4.80)	3.61	7.81	6.71	9.05
115	1.30	1.45	1.65	2.00	2.50	3.40[d]
–	–	–	–	–	–	–

a) 1997 net income and related key ratios are shown after special charges of 6,308 million Swiss francs, net of tax, incurred following the Corange acquisition and include Corange only in respect of balance sheet data.

b) Assuming 1996 centenary warrants held to final exercise date.

c) Dividend 1999 does not include the special dividend relating to the spin-off of the Fragrances and Flavours Division.

d) Dividend 2006 as proposed by the Board of Directors.

Sales by division *in millions of CHF*

	2002	2003	2004	2005	2006
Pharmaceuticals	17,294	19,781	21,695	27,268	33,294
Diagnostics	7,194	7,409	7,827	8,243	8,747
Consumer Health (OTC)	1,578	1,770	1,751	–	–
Vitamins and Fine Chemicals	3,387	2,260	–	–	–
Total	29,453	31,220	31,273	35,511	42,041

Sales by geographical area *in millions of CHF*

	2002	2003	2004	2005	2006
Switzerland	529	529	442	501	471
European Union	9,011	9,681	10,563	11,570	13,627
Rest of Europe	1,439	1,520	993	1,206	1,503
Europe	10,979	11,730	11,998	13,277	15,601
North America	11,102	10,789	11,025	13,479	16,670
Latin America	2,376	2,076	1,825	2,033	2,539
Japan	2,243	3,948	3,875	3,948	3,713
Rest of Asia	1,804	1,697	1,553	1,803	2,384
Asia	4,047	5,645	5,428	5,751	6,097
Africa, Australia and Oceania	949	980	997	971	1,134
Total	29,453	31,220	31,273	35,511	42,041

Additions to property, plant and equipment by division *in millions of CHF*

	2002	2003	2004	2005	2006
Pharmaceuticals	1,040	1,315	1,572	2,613	3,030
Diagnostics	666	764	778	813	846
Consumer Health (OTC)	7	13	6	–	–
Vitamins and Fine Chemicals	298	172	–	–	–
Corporate	33	1	1	2	2
Total	2,044	2,265	2,357	3,428	3,878

Additions to property, plant and equipment by geographical area *in millions of CHF*

	2002	2003	2004	2005	2006
Switzerland	298	262	232	376	350
European Union	598	747	808	908	991
Rest of Europe	79	54	17	27	19
Europe	975	1,063	1,057	1,311	1,360
North America	783	835	1,030	1,752	2,108
Latin America	115	69	74	63	101
Japan	81	220	128	197	201
Rest of Asia	62	50	46	75	69
Asia	143	270	174	272	270
Africa, Australia and Oceania	28	28	22	30	39
Total	2,044	2,265	2,357	3,428	3,878

Supplementary Net Income and EPS Information

The Group's basic and diluted earnings per share information is given in Note 32 to the Consolidated Financial Statements on pages 87–88. Supplementary EPS information is given below on net income before exceptional items and also on core net income, which additionally excludes amortisation of intangible assets and the related impacts on income taxes and minority interests.

Profit from continuing businesses before exceptional items and Core net income *in millions of CHF*

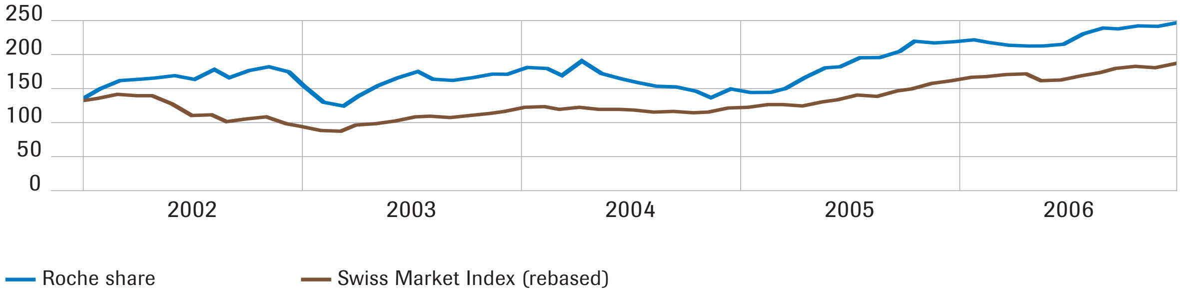
		Year ended 31 December 2006		2005
Profit from continuing businesses		9,151		6,878
Major legal cases	–		356	
– income taxes	–		(135)	
		–		221
Profit from continuing businesses before exceptional items		9,151		7,099
Minority interests				
– profit from continuing businesses	(1,291)		(943)	
		(1,291)		(943)
Net income attributable to Roche shareholders (continuing businesses before exceptional items)		7,860		6,156
Amortisation and impairment of intangible assets	1,174		1,011	
– income taxes	(405)		(359)	
– minority interest	(45)		(51)	
		724		601
Core net income		8,584		6,757

EPS (continuing businesses before exceptional items) and Core EPS

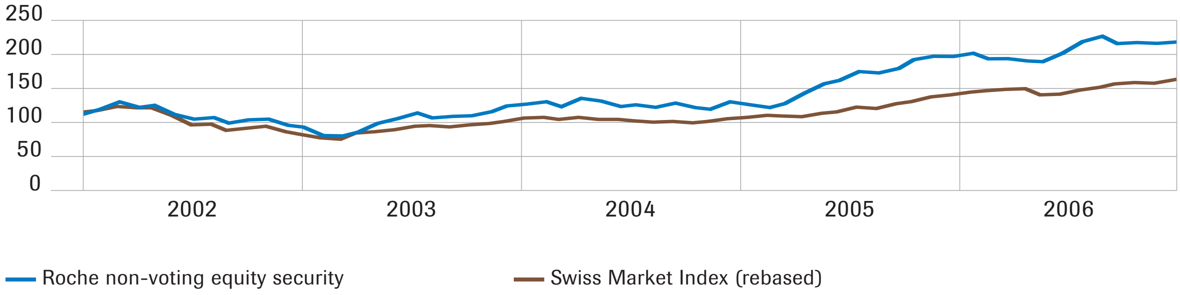
Year ended 31 December	EPS (continuing businesses before exceptional items) 2006	2005	Core EPS 2006	2005
Net income attributable to Roche shareholders (millions of CHF)	7,860	6,156	8,584	6,757
Elimination of interest expense, net of tax, of convertible debt instruments, where dilutive	25	43	25	43
Increase in minority share of net income, net of tax, assuming all outstanding Genentech and Chugai stock options exercised	(100)	(58)	(104)	(63)
Net income used to calculate diluted earnings per share	7,785	6,141	8,505	6,737
Per share information (millions of shares and non-voting equity securities)				
Weighted average number of shares and non-voting equity securities in issue	852	845	852	845
Adjustment for assumed conversion of convertible debt instruments, where dilutive	7	13	7	13
Adjustment for assumed exercise of equity compensation plans, where dilutive	3	2	3	2
Weighted average number of shares and non-voting equity securities in issue used to calculate diluted earnings per share	862	860	862	860
Earnings per share (diluted) (CHF)	9.03	7.14	9.86	7.84

Roche Securities

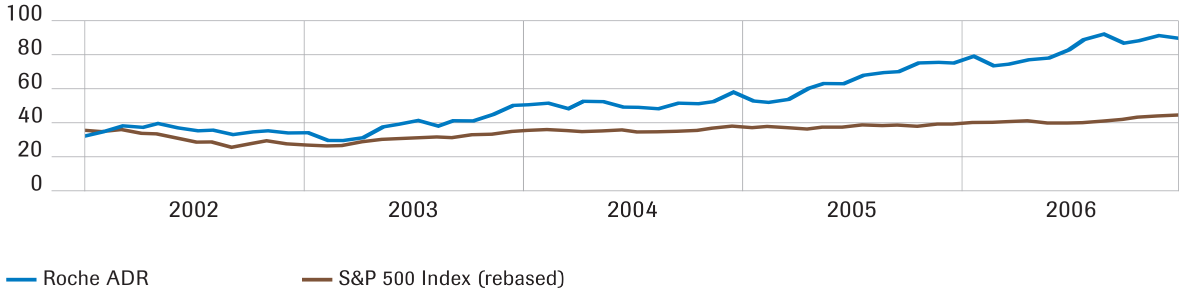
Price development of share *in CHF*



Price development of non-voting equity security *(Genussschein)* *in CHF*



Price development of American Depositary Receipt (ADR) *in USD*



Two Roche American Depositary Receipts (ADRs) are equivalent to one non-voting equity security *(Genussschein)*. ADRs have been traded in the United States over-the-counter market since July 1992.

Information in these tables is restated for the change in the ratio for the ADRs from 1:1 to 2:1 effective 24 January 2005.

Number of shares and non-voting equity securities[a]

		2002	2003	2004	2005	2006
Number of shares (nominal value: CHF 1.00)		160,000,000	160,000,000	160,000,000	160,000,000	160,000,000
Number of non-voting equity securities *(Genussscheine)* (no nominal value)		702,562,700	702,562,700	702,562,700	702,562,700	702,562,700
Total		862,562,700	862,562,700	862,562,700	862,562,700	862,562,700
Data per share and non-voting equity security *in CHF*						
Net income		(4.80)	3.61	7.81	6.71	9.05
Equity		24.13	27.33	32.72	40.49	45.73
Dividend		1.45	1.65	2.00	2.50	3.40[c]
Stock price of share[b]	High	195.00	185.00	193.00	230.00	252.50
	Low	130.50	121.00	137.20	139.00	198.00
	Year-end	175.00	171.50	150.00	219.20	247.50
Stock price of non-voting equity security *(Genussschein)*[b]	High	132.75	125.25	140.25	206.90	227.00
	Low	92.00	75.15	118.75	120.60	185.80
	Year-end	96.35	124.75	130.90	197.30	218.50
Market capitalisation *in millions of CHF*						
	Year-end	93,473	112,210	113,195	170,879	191,575
Key ratios (year-end)						
Net income as % of equity		–19	13	24	17	20
Dividend yield of shares in %		0.8	1.0	1.3	1.1	1.4
Dividend yield of non-voting equity securities *(Genussscheine)* in %		1.5	1.3	1.5	1.3	1.6
Price/earnings of shares		–36	48	19	33	27
Price/earnings of non-voting equity securities *(Genussscheine)*		–20	35	17	29	24

a) Each non-voting equity security *(Genussschein)* confers the same rights as any of the shares to participate in the available earnings and any remaining proceeds from liquidation following repayment of the nominal value of the shares and the participation certificate capital (if any). Shares and non-voting equity securities are listed on the Swiss Exchange. Roche Holding Ltd has no restrictions as to ownership of its shares or non-voting equity securities.
b) All stock price data reflect daily closing prices.
c) 2006 dividend as proposed by the Board of Directors.

Ticker symbols

	Share	Non-voting equity security	American Depositary Receipt
Reuters	RO.S	ROG.VX	RHHBY.PK
Bloomberg	RO SW	ROG VX	RHHBY US
SWX Swiss Exchange	RO	ROG	–

Roche Holding Ltd, Basel

Financial Statements

Income statement *in millions of CHF*

	2006	2005
Income		
Income from participations	3,483	2,309
Interest income from loans to Group companies	70	79
Interest and investment income	19	9
Other income	3	50
Total income	3,575	2,447
Expenses		
Financial expenses	(3)	(12)
Administration expenses	(26)	(30)
Other expenses	(2)	(2)
Total expenses	(31)	(44)
Profit for the year before taxes	3,544	2,403
Taxes	(11)	(13)
Net profit for the year	3,533	2,390

Balance sheet at 31 December *in millions of CHF*

	2006	2005
Non-current assets		
Participations	4,557	4,557
Long-term loans to Group companies	3,286	914
Total non-current assets	7,843	5,471
Current assets		
Short-term loans to Group companies	–	1,433
Accounts receivable from Group companies	25	52
Other accounts receivable	1	2
Marketable securities	3,036	2,403
Liquid funds	23	289
Total current assets	3,085	4,179
Total assets	10,928	9,650
Equity		
Share capital	160	160
Non-voting equity securities *(Genussscheine)*	p.m.	p.m.
General legal reserve	300	300
Free reserve	4,647	4,414
Special reserve	2,152	2,152
Available earnings:		
– Balance brought forward from previous year	4	4
– Net profit for the year	3,533	2,390
Total equity	10,796	9,420
Non-current liabilities		
Provisions	35	35
Total non-current liabilities	35	35
Current liabilities		
Accounts payable to Group companies	–	11
Unrealised foreign currency gains	82	165
Other liabilities	15	19
Total current liabilities	97	195
Total liabilities	132	230
Total equity and liabilities	10,928	9,650

p.m. = pro memoria. Non-voting equity securities have no nominal value.

Notes to the Financial Statements

General

The financial statements of Roche Holding Ltd, Basel, are prepared in accordance with the provisions of Swiss law.

Valuation methods and translation of foreign currencies

Marketable securities are reported at the lower of cost or market value. All other assets, including participations, are reported at cost less appropriate write-downs. Assets and liabilities denominated in foreign currencies are translated into Swiss francs using year-end rates of exchange, except participations which are translated at historical rates. Transactions during the year which are denominated in foreign currencies are translated at the exchange rates effective at the relevant transaction dates. Resulting exchange gains and losses are recognised in the income statement with the exception of unrealised gains which are deferred.

Details to specific items

Taxes

The tax charge includes corporate income and capital taxes.

Equity

Movement in recognised amounts *in millions of CHF*

	Share capital	General legal reserve	Free reserve	Special reserve	Available earnings	Total equity
As at 1 January 2004	160	300	4,184	2,152	1,567	8,363
– Net income	–	–	–	–	1,815	1,815
– Dividends paid	–	–	–	–	(1,423)	(1,423)
– Transfer to free reserve	–	–	140	–	(140)	–
As at 31 December 2004	160	300	4,324	2,152	1,819	8,755
– Net income	–	–	–	–	2,390	2,390
– Dividends paid	–	–	–	–	(1,725)	(1,725)
– Transfer to free reserve	–	–	90	–	(90)	–
As at 31 December 2005	160	300	4,414	2,152	2,394	9,420
– Net income	–	–	–	–	3,533	3,533
– Dividends paid	–	–	–	–	(2,157)	(2,157)
– Transfer to free reserve	–	–	233	–	(233)	–
As at 31 December 2006	160	300	4,647	2,152	3,537	10,796

Share capital

As in the previous year, share capital amounts to 160 million Swiss francs. The share capital consists of 160,000,000 bearer shares with a nominal value of 1 Swiss franc each. Included in equity are 702,562,700 non-voting equity securities *(Genussscheine)*. They are not part of the share capital and confer no voting rights. However each non-voting equity security *(Genussschein)* does confer the same rights as any one of the shares to participate in the available earnings and in any remaining proceeds from liquidation following repayment of the share capital.

Guarantees

Within the framework of the European Medium Term Note (EMTN) programme the company has issued guarantees in favour of Group companies amounting to 2,993 million Swiss francs (previous year 2,991 million Swiss francs).

At the time of preparing the balance sheet no risks arising out of these contingent liabilities were discernible.

Convertibles and options
Reference is made to the Notes to the Roche Group Consolidated Financial Statements.

Own equity instruments
Reference is made to the Notes to the Roche Group Consolidated Financial Statements.

Pledged assets
As at 31 December 2006 and 2005 no assets have been pledged as security for the Company's own commitments.

Participations
The major participations are listed in Note 37 to the Roche Group Consolidated Financial Statements.

Important shareholders
All shares in the Company are bearer shares, and for this reason the Company does not keep a register of shareholders. The following figures are based on information from shareholders, the shareholder validation check at the Annual General Meeting of 27 February 2006 and on other information available to the Company.

80,020,000 (previous year 80,020,000) shares: Shareholder group with pooled voting rights, comprising Ms Vera Michalski-Hoffmann, Ms Maja Hoffmann, Mr André Hoffmann, Dr Andreas Oeri, Ms Sabine Duschmalé-Oeri, Ms Catherine Oeri, Ms Beatrice Oeri and Ms Maja Oeri.[a)]

53,332,863 (previous year 53,332,863) shares (participation below 33⅓%): Novartis International Ltd, Basel including affiliates thereof.[b)]

a) Information supplied by the shareholders. This figure of 80,020,000 shares does not include shares without pooled voting rights held outside the group by individual members of the group.
b) Figures as of 31 December 2006 supplied by Novartis International Ltd, Basel.

Appropriation of Available Earnings

Proposals to the Annual General Meeting *in CHF*

	2006	2005
Available earnings		
Net profit for the year	3,532,914,531	2,389,789,792
Balance brought forward from previous year	4,318,930	3,935,888
Total available earnings	3,537,233,461	2,393,725,680
Appropriation of available earnings		
Distribution of an ordinary dividend of CHF 3.40 gross per share and non-voting equity security *(Genussschein)* as against CHF 2.50 last year	(2,932,713,180)	(2,156,406,750)
Transfer to free reserve	(604,000,000)	(233,000,000)
Total appropriation of available earnings	(3,536,713,180)	(2,389,406,750)
To be carried forward on this account	520,281	4,318,930

Report of the Statutory Auditors

Report of the Statutory Auditors to the Annual General Meeting of Roche Holding Ltd, Basel

As statutory auditors, we have audited the accounting records and the financial statements (income statement, balance sheet and notes on pages 104 to 108) of Roche Holding Ltd for the year ended 31 December 2006.

These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss auditing standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements and the proposed appropriation of available earnings comply with Swiss law and the Company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

KPMG

KPMG Klynveld Peat Marwick Goerdeler SA

John A. Morris
Auditor in charge

Erik F. J. Willems

Basel, 1 February 2007

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Cautionary statement regarding forward-looking statements

This Annual Report contains certain forward-looking statements. These forward-looking statements may be identified by words such as 'believes', 'expects', 'anticipates', 'projects', 'intends', 'should', 'seeks', 'estimates', 'future' or similar expressions or by discussion of, among other things, strategy, goals, plans or intentions. Various factors may cause actual results to differ materially in the future from those reflected in forward-looking statements contained in this Annual Report, among others: (1) pricing and product initiatives of competitors; (2) legislative and regulatory developments and economic conditions; (3) delay or inability in obtaining regulatory approvals or bringing products to market; (4) fluctuations in currency exchange rates and general financial market conditions; (5) uncertainties in the discovery, development or marketing of new products or new uses of existing products, including without limitation negative results of clinical trials or research projects, unexpected side effects of pipeline or marketed products; (6) increased government pricing pressures; (7) interruptions in production; (8) loss of or inability to obtain adequate protection for intellectual property rights; (9) litigation; (10) loss of key executives or other employees; and (11) adverse publicity and news coverage.

The statement regarding earnings per share growth is not a profit forecast and should not be interpreted to mean that Roche's earnings or earnings per share for 2007 or any subsequent period will necessarily match or exceed the historical published earnings or earnings per share of Roche.

Next Annual General Meeting: 5 March 2007

The Roche Annual Report is published in German and English.

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