Roche Holdings, Inc.
Interim Financial Statements 2014

Roche Holdings, Inc. Interim Financial Statements

Contents

Interim Management Report

1. Review of the first six months ended June 30, 2014

Principal activities

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

RHI Group results

During the first half of 2014 the RHI Group reported sales growth of 6% to $10.6 billion and a fall in operating profit of 10% to $4.4 billion. RHI had a positive cash flow from operating activities of $4.3 billion. Sales in the Pharmaceuticals Division rose by 6% to $9.0 billion driven by growth in the oncology portfolio. The key growth drivers in oncology were the HER2 breast cancer franchise (Perjeta, Herceptin and Kadcyla), Avastin and Rituxan. Sales of Xolair, Lucentis and Actemra also increased. Growth was negatively impacted by a decline in Pegasys and Xeloda. Sales in the Diagnostics Division increased by 5% to $1.6 billion with growth in Professional Diagnostics, Tissue Diagnostics and Molecular Diagnostics being partially offset by a decline in Diabetes Care. The RHI Group's operating profit fell mainly due to higher goodwill and intangible asset impairment charges compared to the first half of 2013. This was partially offset by growth in the underlying operating performance. As a result, the RHI Group's operating profit margin fell by 7.2 percentage points to 41.6% of sales. The RHI Group's net income decreased by 25% to $2.0 billion driven by the operating result explained above and higher income tax expenses.

Pharmaceuticals Division

Pharmaceuticals Division sales increased by 6% to $9.0 billion. The leading products were the oncology medicines Rituxan, the HER2 breast cancer franchise (Herceptin, Perjeta and Kadcyla) and Avastin with sales of $1.8 billion (+4%), $1.6 billion (+32%) and $1.5 billion (+6%), respectively. Of the other products, the main growth drivers were Xolair (+19%), Lucentis (+6%) and Actemra (+26%). Growth was negatively impacted by a decline in Pegasys (-28%), due to competition from interferon-free medicines, and Xeloda (-47%) which is now off-patent.

In oncology, the HER2 franchise benefited from strong demand for Perjeta, continued growth for Herceptin and an increase in the uptake of Kadcyla. Perjeta sales grew significantly in both metastatic and pre-surgical breast cancer. Herceptin sales grew primarily from increased usage in the treatment of breast cancer in combination with Perjeta. Avastin showed strong growth driven by expanded use in colorectal and lung cancer. In immunology, demand for Actemra was particularly strong and the subcutaneous formulation for Actemra is now approved. In ophthalmology, Lucentis sales grew driven largely by increased adoption in treating DME (diabetic macular edema).

Royalties and other operating income were stable at $2.2 billion, due to higher royalty income being offset by lower income from out-licensing agreements. The increase in royalty income was due to higher related-party royalty bearing sales for Perjeta, Avastin, Kadcyla, Rituxan and Herceptin. The decrease in out-licensing income was mainly due to the recognition of previously deferred income from related-parties under research and development cost-sharing agreements in the first half of 2013, partially offset by higher income from related-parties under research and development cost-sharing agreements in the first half of 2014.

Cost of sales increased by 6% to $2.7 billion mainly driven by higher sales volumes and increased costs from collaboration and profit sharing agreements due to higher sales of Xolair, Rituxan and Tarceva. As a percentage of sales, cost of sales remained stable at 29.9%. Royalty expenses were 5.4% lower due to changes in agreement terms for Lucentis.

Marketing and distribution costs increased by 9% to $1.1 billion. Marketing efforts focused on newly launched products such as Kadcyla and Gazyva, as well as supporting established oncology products.

Research and development costs were stable at $2.0 billion. There were increased investments in the oncology franchise with the progression of developments such as PDL1 targeted therapy. These were partially offset by lower spending in cardiovascular and metabolism following the termination of aleglitazar in the first half of 2013. Costs of $47 million were incurred following the outcomes of certain onartuzumab Phase III clinical studies for the accelerated recognition of the remaining trial costs. There were intangible asset impairment charges of $64 million related to decisions to stop development on two compounds. The Pharmaceuticals Division spent $56 million on the in-licensing of pipeline compounds and technologies, which are capitalised as intangible assets.

General and administration costs increased by 7% to $0.3 billion mainly driven by higher legal costs, an increase in business taxes, including the costs for the U.S. Branded Pharmaceutical product Fee of $110 million (six months ended June 30, 2013: $96 million), partly offset by lower Nutley site closure costs.

The Pharmaceuticals Division's operating profit increased by 6% to $5.1 billion, driven by the strong operating performance.

Diagnostics Division

Diagnostics Division sales increased by 5% to $1.6 billion. Professional Diagnostics sales increased by 10% to $0.6 billion, primarily driven by the clinical chemistry business, supported by the immunodiagnostics business.

Molecular Diagnostics sales increased by 6% to $0.4 billion, due to growth in the underlying molecular businesses of 9%, with the major contributions coming from the Blood screening, HPV (cervical cancer screening) and Virology businesses. This was partly offset by a sales decline in the genome sequencing business. In the first half of 2014 the FDA approved the cobas HPV test for first-line primary screening for cervical cancer. In June 2014 RHI acquired Genia Technologies, Inc., which is developing a single-molecule, semiconductor-based DNA sequencing platform using nanopore technology. Also in June 2014 RHI acquired IQuum, Inc., which is focused on developing point-of-care products for the molecular diagnostics market. The IQuum acquisition provides Roche with access to the Laboratory-in-a-tube (Liat™) system, which performs rapid and simple molecular diagnostic testing.

Tissue Diagnostics sales increased by 7% to $0.3 billion, driven by the advanced staining portfolio partially offset by reimbursement changes. Impairments of $604 million to goodwill and $173 million to product intangible assets were recorded in Tissue Diagnostics. The factors leading to these impairments were a change in the timelines for future product development combined with reduced revenue expectations following additional reimbursement cuts in the U.S. and a change in the discount rate used for the impairment testing.

Diabetes care sales decreased by 6% to $0.3 billion, due to the Medicare reimbursement cut in 2013 on strips and lower pump sales as well as continuing challenging market conditions for the blood glucose (bG) monitoring portfolio.

Royalties and other operating income decreased by 35% to $0.1 billion mainly due to lower royalty income in Professional Diagnostics.

Costs of sales increased by 19% to $1.1 billion mainly due to higher period costs as a result of product-related provisions and product intangible asset impairment charges of $173 million incurred in the Tissue Diagnostics business. As a percentage of sales, cost of sales increased by 8.3 percentage points to 71.9%.

Marketing and distribution costs were stable at $0.4 billion mainly due to lower field force expenses being offset by increased spending in marketing support in Molecular and Tissue Diagnostics.

Research and development costs increased by 22% to $0.1 billion mainly due to lower income from related-parties under research and development cost-sharing agreements.

General and administration costs increased by $0.6 billion to $0.7 billion mainly due to the goodwill impairment charge of $604 million in the Tissue Diagnostics business.

Restructuring plans

The RHI Group continued with the implementation of several major restructuring plans initiated in prior years with a total cost of $63 million in the first half of 2014, compared to $122 million in the first half of 2013. The decrease in restructuring costs was mainly due to lower Nutley site closure costs in the first half of 2014.

Impairment of goodwill and intangible assets

Impairment charges of $841 million were recorded for goodwill and intangible assets in the first half of 2014. This related to impairments of $604 million for goodwill and $173 million for product intangibles in the Tissue Diagnostics business and $64 million for product intangibles in the Pharmaceutical Division.

Treasury and taxation results

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

Financing costs remained stable at $0.6 billion in the first half of 2014. The main drivers are a decrease of $80 million in interest expense, which reflects the continued repayment of bonds and notes incurred to finance the Genentech transaction, partially offset by an increase of $57 million in the losses on redemption and repurchase of bonds and notes. At June 30, 2014 debt was $34.3 billion compared to $33.6 billion at the end of 2013. This increase in debt was mainly due to the issuance of commercial paper of $2.1 billion and an increase of $0.4 billion due to related parties, partially offset by bond and note redemptions of $1.9 billion during the first half of 2014.

The RHI Group's effective tax rate for the six months ended June 30, 2014 increased to 42.8% (six months ended June 30, 2013: 32.4%). This was mainly due to the goodwill impairment in the first half of 2014 that is not tax deductible. The expiration of the U.S. research and development tax credits at the end of 2013 also contributed to the increase in the effective tax rate. In addition the effective tax rate in the first half of 2013 includes the retrospective re-enactment of the 2012 tax credits in January 2013, which means that the six months ended June 30, 2013 included a whole year of tax credits in respect of 2012 as well as six months of tax credits for 2013.

Cash flow

The cash inflows from operating activities increased by $0.8 billion to $4.3 billion in the first half of 2014. This was mainly due to a net decrease in working capital, increased cash generated from operations and lower income tax payments which decreased by $0.1 billion to $1.1 billion. The cash outflows from investing activities increased by $0.5 billion to $0.8 billion mainly due to the acquisitions of Genia Technologies, Inc. and IQuum, Inc. in June 2014 and increased investments in property, plant and equipment. The cash outflows from financing activities of $3.4 billion were mainly due to dividends paid to related parties of $2.4 billion, bond and note debt repayments of $1.9 billion, interest payments of $1.0 billion and equity compensation plan payments of $0.7 billion, partly offset by $2.1 billion received from the issuance of commercial paper.

Financial position

In 2009 the Genentech transaction was accounted for in full as an equity transaction and as a consequence, the carrying amount of the consolidated equity of the RHI Group was significantly reduced (see Note 1 to the RHI Interim Financial Statements). At June 30, 2014 the RHI Group had a negative equity of $22.3 billion (December 31, 2013: $20.9 billion). The capacity of the RHI Group to generate positive cash flows and operating profit is not affected by this accounting treatment. In addition RHI has bonds, notes and commercial paper outstanding with a carrying value of $14.5 billion which are guaranteed by Roche Holding Ltd, the parent company of the Roche Group.

Total assets increased by $0.3 billion to $25.0 billion at June 30, 2014 mainly due to increases in intangible assets, deferred tax assets and inventories partially offset by decreases in goodwill and accounts receivables. Total liabilities increased by $1.7 billion to $47.3 billion at June 30, 2014 mainly due to an increase in debt, tax liabilities and provisions. At June 30, 2014 the carrying value of debt was $34.3 billion (December 31, 2013: $33.6 billion), of which $18.1 billion (December 31, 2013: $17.7 billion) is due to related parties.

Merger and acquisitions

On June 3, 2014 the RHI Group acquired a 100% controlling interest in Genia Technologies, Inc. ('Genia'), a U.S. private company based in California. Genia is developing a single-molecule, semiconductor based DNA sequencing platform using nanopore technology. Genia is reported in the Diagnostics operating segment as part of the Sequencing business. The purchase consideration was $125 million in cash and up to $225 million from a contingent consideration arrangement.

On June 10, 2014 the RHI Group acquired a 100% controlling interest in IQuum, Inc. ('IQuum'), a U.S. private company based in Massachusetts. IQuum has developed the Laboratory-in-a-tube (Liat™) system, which enables healthcare workers to perform rapid molecular diagnostic testing in a point-of-care setting, closer to patients and with minimal training. IQuum is reported in the Diagnostics operating segment as part of the Molecular Diagnostics business. The purchase consideration was $282 million in cash and up to $175 million from a contingent consideration arrangement. In addition the RHI Group acquired 100% controlling interest in the related intellectual property holding company for a cash consideration of $35 million.

On July 2, 2014 the RHI Group announced an agreement to acquire a 100% controlling interest in Seragon Pharmaceuticals, Inc. ('Seragon'), a U.S. private company based in San Diego, California. The closing of the transaction is expected in the third quarter of 2014. With the acquisition, the RHI Group will obtain rights to Seragon's entire portfolio of selective estrogen receptor degraders (SERDs) for the potential treatment of hormone receptor-positive cancers. Seragon will be reported in the Pharmaceuticals Division. The purchase consideration will be $725 million in cash and up to $1 billion from a contingent consideration arrangement.

2. Principal risks and uncertainties

Risks

The RHI Group is exposed to various financial risks arising from its underlying operations and corporate finance activities. The RHI Group's financial risk exposures are predominantly related to changes in interest rates, equity prices and to an extent, foreign exchange rates, as well as the creditworthiness and the solvency of RHI's counterparties. The RHI Group's financial risk management is described in Note 26 to the RHI Annual Financial Statements.

Uncertainties

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

3. Responsibility statement

The directors of Roche Holdings, Inc. confirm that, to the best of their knowledge as of the date of their approval of the Interim Consolidated Financial statements at July 25, 2014:

- the Interim Consolidated Financial Statements at July 25, 2014, which have been prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of Roche Holdings, Inc. and the undertakings included in the consolidation taken as a whole; and that
- the Management Report gives a true and fair view of the development and performance of the business and the position of Roche Holdings, Inc. and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Severin Schwan Chairman of the Board	Alan Hippe Vice Chairman of the Board	Bruce Resnick Member of the Board
Roger Brown Member of the Board	Frederick C. Kentz III Member of the Board	David P. McDede Member of the Board

Roche Holdings, Inc. Interim Consolidated Financial Statements

The Interim Consolidated Financial Statements have been reviewed by Roche Holdings, Inc.'s auditor and their review report is presented on page 24.

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

	Six months ended June 30, 2014	2013
Sales [2]	**10,624**	**10,004**
Royalties and other operating income [2]	2,276	2,340
Cost of sales	(3,840)	(3,506)
Marketing and distribution	(1,483)	(1,392)
Research and development	(2,128)	(2,101)
General and administration	(1,031)	(464)
Operating profit [2]	**4,418**	**4,881**
Financing costs [3]	(601)	(631)
Financing costs – related parties [13]	(387)	(410)
Other financial income (expense) [3]	14	97
Other financial income (expense) – related parties [13]	(2)	(64)
Profit before taxes	**3,442**	**3,873**
Income taxes [4]	(1,473)	(1,256)
Net income	**1,969**	**2,617**

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

	Six months ended June 30, 2014	2013
Net income recognised in income statement	**1,969**	**2,617**
Other comprehensive income		
Remeasurements of defined benefits plans	(85)	296
Items that will not be reclassified to the income statement	**(85)**	**296**
Available-for-sale investments	-	7
Cash flow hedges	27	5
Items that may be reclassified subsequently to the income statement	**27**	**12**
Other comprehensive income, net of tax	**(58)**	**308**
Total comprehensive income	**1,911**	**2,925**

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

	June 30, 2014	December 31, 2013
Non-current assets	16,902	16,706
Current assets	8,069	7,993
Total assets	**24,971**	**24,699**
Non-current liabilities	(28,500)	(29,716)
Current liabilities	(18,802)	(15,890)
Total liabilities	**(47,302)**	**(45,606)**
Total net liabilities	**(22,331)**	**(20,907)**
Equity		
Capital and reserves	(22,331)	(20,907)
Total equity	**(22,331)**	**(20,907)**

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

	Six months ended June 30,	
	2014	2013
Cash flows from operating activities, before income taxes paid	5,333	4,693
Income taxes paid	(1,076)	(1,205)
Cash flows from operating activities	4,257	3,488
Cash flows from investing activities	(825)	(325)
Cash flows from financing activities	(3,437)	(3,170)
Increase (decrease) in cash and cash equivalents	**(5)**	**(7)**
Cash and cash equivalents at beginning of period	(69)	(110)
Cash and cash equivalents at end of period [a]	**(74)**	**(117)**

[a] Cash overdrafts of $74 million (2013: $117 million) are included within current liabilities in the balance sheet.

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

	Share capital	Retained earnings	Fair value reserve	Hedging reserve	Total equity
Six months ended June 30, 2013					
At January 1, 2013	**1**	**(24,929)**	**90**	**53**	**(24,785)**
Net income recognised in income statement	-	2,617	-	-	2,617
Available-for-sale investments	-	-	7	-	7
Cash flow hedges	-	-	-	5	5
Remeasurements of defined benefit plans	-	296	-	-	296
Total comprehensive income	**-**	**2,913**	**7**	**5**	**2,925**
Dividends	-	-	-	-	-
Equity compensation plans	-	(584)	-	-	(584)
At June 30, 2013	**1**	**(22,600)**	**97**	**58**	**(22,444)**
Six months ended June 30, 2014					
At January 1, 2014	**1**	**(21,096)**	**104**	**84**	**(20,907)**
Net income recognised in income statement	-	1,969	-	-	1,969
Available-for-sale investments	-	-	-	-	-
Cash flow hedges	-	-	-	27	27
Remeasurements of defined benefit plans	-	(85)	-	-	(85)
Total comprehensive income	**-**	**1,884**	**-**	**27**	**1,911**
Dividends	-	(2,500)	-	-	(2,500)
Equity compensation plans	-	(835)	-	-	(835)
At June 30, 2014	**1**	**(22,547)**	**104**	**111**	**(22,331)**

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

1. Accounting policies

Basis of preparation

These financial statements are the unaudited condensed interim consolidated financial statements (hereafter 'the Interim Financial Statements') of Roche Holdings, Inc., a company incorporated in the State of Delaware, and its subsidiaries (hereafter 'RHI' or 'the RHI Group') for the six months ended June 30, 2014 (hereafter 'the interim period'). RHI is 100% indirectly owned by Roche Holding Ltd, a public company registered in Switzerland and parent company of the Roche Group. The RHI Group is therefore a member of the Roche Group. These Interim Financial Statements should be read in conjunction with the Consolidated Financial Statements for the year ended December 31, 2013 (hereafter 'the Annual Financial Statements'), as they provide an update of previously reported information. They were approved for issue by the Board of Directors on July 25, 2014.

Statement of compliance

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

Going concern

The RHI Group completed the purchase of the non-controlling interests in Genentech, effective March 26, 2009. Based on the International Accounting Standard 27 'Consolidated and Separate Financial Statements' (IAS 27) and consistent with the International Financial Reporting Standard 10 'Consolidated Financial Statements' (IFRS 10), which was adopted by RHI in 2013, this transaction was accounted for in full as an equity transaction. As a consequence, the carrying amount of the consolidated equity of the RHI Group at that time was reduced by $46.6 billion, of which $7.6 billion was allocated to eliminate the book value of Genentech non-controlling interests. At June 30, 2014 the RHI Group had a negative equity of $22.3 billion (December 31, 2013: $20.9 billion). The capacity of the RHI Group to generate positive cash flows and operating profit is not affected by this accounting treatment. In addition, RHI has bonds, notes and commercial paper outstanding with a carrying value of $14.5 billion which are guaranteed by Roche Holding Ltd. Management has assessed that it remains appropriate to prepare the RHI Group's financial statements on a going concern basis. In the 2014 interim period, the RHI Group generated an operating profit of $4.4 billion and a positive operating cash flow of $4.3 billion.

Management judgments and estimates

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

Seasonality

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

Significant accounting policies

Except as described below, the accounting policies applied in these Interim Financial Statements are the same as those applied in the Annual Financial Statements. The following changes in accounting policies will be reflected in the RHI Group's Consolidated Financial Statements for the year ended December 31, 2014.

Changes in accounting policies

The RHI Group has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of January 1, 2014.

- Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)
- Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)
- Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)
- Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)
- IFRIC 21 'Levies'

These do not have a material impact on the RHI Group's overall results and financial position.

Future new and revised standards

The RHI Group is currently assessing the potential impacts of the various new and revised standards and interpretations that will be mandatory from January 1, 2015 which the RHI Group has not yet applied. Based on the analysis to date, the RHI Group does not anticipate that these will have a material impact on the RHI Group's overall results and financial position. The RHI Group is also assessing other new and revised standards which are not mandatory until after 2015, notably IFRS 9 'Financial Instruments' and IFRS 15 'Revenues from Contracts with Customers'.

2. Operating segment information

The RHI Group has two divisions, Pharmaceuticals and Diagnostics. Revenues are primarily generated from the sale of prescription pharmaceutical products and diagnostic instruments, reagents and consumables, respectively. Both divisions also derive revenues from the sale or licensing of products or technology to third parties. Certain corporate activities that cannot be reasonably allocated to the other reportable business segments based on RHI's management and organisational structure are reported as 'Corporate'. These include certain functions for communications, human resources, finance (including treasury, taxes and pension fund management), legal, safety and environmental services.

Divisional information *in millions of USD*

	Pharmaceuticals		Diagnostics		Corporate		RHI Group	
Six months ended June 30,	2014	2013	2014	2013	2014	2013	2014	2013
Revenues from external customers and related parties								
Sales	9,039	8,492	1,585	1,512	-	-	10,624	10,004
Royalties and other operating income	2,171	2,179	105	161	-	-	2,276	2,340
Total	**11,210**	**10,671**	**1,690**	**1,673**	**-**	**-**	**12,900**	**12,344**
Segment results								
Operating profit	5,058	4,787	(636)	132	(4)	(38)	4,418	4,881

Net operating assets *in millions of USD*

	Assets		Liabilities		Net assets	
	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
Pharmaceuticals	12,707	12,516	(4,938)	(5,049)	7,769	7,467
Diagnostics	7,275	7,242	(1,277)	(1,050)	5,998	6,192
Corporate	28	29	(300)	(328)	(272)	(299)
Total operating	**20,010**	**19,787**	**(6,515)**	**(6,427)**	**13,495**	**13,360**
Non-operating	4,961	4,912	(40,787)	(39,179)	(35,826)	(34,267)
RHI Group	**24,971**	**24,699**	**(47,302)**	**(45,606)**	**(22,331)**	**(20,907)**

3. Net financial expense

Financing costs *in millions of USD*

	Six months ended June 30, 2014	2013
Interest expense	(416)	(496)
Amortisation of debt discount [10]	(9)	(10)
Net gains (losses) on redemption and repurchase of bonds and notes [10]	(142)	(85)
Discount unwind	(8)	(6)
Net interest cost of defined benefit plans	(26)	(34)
Total financing costs	**(601)**	**(631)**

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

	Six months ended June 30, 2014	2013
Net gains (losses) on sale of equity securities	10	25
Write-downs and impairments of equity securities	-	(1)
Net income from equity securities	**10**	**24**
Foreign exchange gains (losses)	4	69
Net other financial income (expense)	-	4
Total other financial income (expense)	**14**	**97**

Interest expense decreased by $80 million mainly due to the lower level of debt with third parties following debt repayments during the six months ended June 30, 2014.

Net financial expense *in millions of USD*

	Six months ended June 30, 2014	2013
Financing costs	(601)	(631)
Other financial income (expense)	14	97
Net financial expense	**(587)**	**(534)**
Financial result from Treasury management	(561)	(500)
Financial result from Pension management	(26)	(34)
Net financial expense	**(587)**	**(534)**

4. Income taxes

Income tax expense is recognised based upon management's best estimate of the weighted average income tax rate expected for the full financial year multiplied by the pre-tax income for the six months ended June 30, 2014.

Income tax expenses *in millions of USD*

	Six months ended June 30, 2014	2013
Current income taxes	(1,622)	(1,287)
Deferred income taxes	149	31
Total income tax (expense)	**(1,473)**	**(1,256)**

The RHI Group's effective tax rate for the six months ended June 30, 2014 increased to 42.8% (six months ended June 30, 2013: 32.4%). This was mainly due to the goodwill impairment in the first half of 2014 that is not tax deductible. The expiration of the U.S. research and development tax credits at the end of 2013 also contributed to the increase in the effective tax rate. In addition the effective tax rate in the first half of 2013 includes the retrospective re-enactment of the 2012 tax credits in January 2013, which means that the six months ended June 30, 2013 included a whole year of tax credits in respect of 2012 as well as six months of tax credits for 2013.

5. Business combinations

Acquisitions - 2014

Genia Technologies, Inc. On June 3, 2014 the RHI Group acquired a 100% controlling interest in Genia Technologies, Inc. ('Genia'), a U.S. private company based in California. Genia is developing a single-molecule, semiconductor based DNA sequencing platform using nanopore technology. Genia is reported in the Diagnostics operating segment as part of the Sequencing business. The total consideration was $255 million, of which $125 million was paid in cash and $130 million arose from a contingent consideration arrangement. The contingent payments are based on the achievement of performance-related milestones that may arise until June 2024 and the range of undiscounted outcomes is between zero and $225 million.

IQuum, Inc. On June 10, 2014 the RHI Group acquired a 100% controlling interest in IQuum, Inc. ('IQuum'), a U.S. private company based in Massachusetts. IQuum has developed the Laboratory-in-a-tube (Liat™) system, which enables healthcare workers to perform rapid molecular diagnostic testing in a point-of-care setting, closer to patients and with minimal training. IQuum is reported in the Diagnostics operating segment as part of the Molecular Diagnostics business. The total consideration was $430 million, of which $282 million was paid in cash and $148 million arose from a contingent consideration arrangement. The contingent payments are based on the achievement of performance-related milestones that may arise until the first half of 2017 and the range of undiscounted outcomes is between zero and $175 million. In addition, the RHI Group acquired 100% controlling interest in the related intellectual property holding company for a cash consideration of $35 million.

The identifiable assets acquired and liabilities assumed are set out in the table below. The amounts for both IQuum and Genia are provisional based on preliminary information and valuations of the assets and liabilities. They are subject to adjustment during the second half of 2014 if new information is obtained about the facts that existed at the acquisition date.

Acquisitions - 2014: net assets acquired *in millions of USD*

	Genia	IQuum	Total
Intangible assets			
- Product intangibles: in use [8]	-	237	237
– Product intangibles: not available for use [8]	253	-	253
Deferred tax liabilities	(100)	(81)	(181)
Other net assets (liabilities)	–	6	6
Net identifiable assets	**153**	**162**	**315**
Goodwill [7]	102	303	405
Total consideration	**255**	**465**	**720**
Cash	125	317	442
Contingent consideration [12]	130	148	278
Total consideration	**255**	**465**	**720**

The fair value of the intangible assets is determined using an excess earning method that is based on management forecasts and observable market data for discount rates, tax rates and foreign exchange rates. The present value is calculated using a risk-adjusted discount rate of 10.0% for IQuum and 13.7% for Genia. The valuations were performed by independent valuers.

Goodwill represents a control premium and synergies that can be obtained from the RHI Group's existing business. None of the goodwill is expected to be deductible for income tax purposes. Directly attributable transaction costs of $3 million are reported in the Diagnostics operating segment within general and administration expenses. The impact of the IQuum and Genia acquisitions on the results reported for the Diagnostics Division and the RHI Group were not material.

Future acquisitions - 2014

Seragon Pharmaceuticals, Inc. On July 2, 2014 the RHI Group announced an agreement to acquire a 100% controlling interest in Seragon Pharmaceuticals, Inc. ('Seragon'), a U.S. private company based in San Diego, California. The closing of the transaction is expected in the third quarter of 2014. With the acquisition, the RHI Group will obtain rights to Seragon's entire portfolio of selective estrogen receptor degraders (SERDs) for the potential treatment of hormone receptor-positive cancers. Seragon's lead product candidate, ARN-810, is a next-generation SERD that is currently in Phase I clinical trials for patients who have hormone receptor-positive breast cancer and have failed current hormonal agents. Seragon will be reported in the Pharmaceuticals Division. The purchase consideration will be $725 million in cash and up to $1 billion from a contingent consideration arrangement.

Cash flows from business combinations

Acquisitions: net cash outflow *in millions of USD*

	Six months ended June 30,	
	2014	2013
Cash consideration paid	(442)	-
Cash in acquired company	5	-
Contingent consideration paid [12]	(25)	-
Total net cash outflow	**(462)**	**-**

6. Restructuring plans

During the six months ended June 30, 2014 the RHI Group continued with the implementation of several major restructuring plans initiated in prior years.

Restructuring plans: costs incurred *in millions of USD*

	Diagnostics [1]	Site consolidation [2]	Other Plans [3]	Total
Six months ended June 30, 2014				
Restructuring costs				
- Employee-related costs	9	1	19	29
- Site closure costs	1	14	-	15
- Other reorganisation expenses	15	2	2	19
Total restructuring costs	**25**	**17**	**21**	**63**
Additional costs				
- Impairment of goodwill	-	-	-	-
- Impairment of intangible assets	-	-	-	-
- Legal and environmental costs	-	-	-	-
Total costs	**25**	**17**	**21**	**63**
Six months ended June 30, 2013				
Restructuring costs				
- Employee related costs	8	28	11	47
- Site closure costs	3	-	1	4
- Other reorganisation expenses	4	34	-	38
Total restructuring costs	**15**	**62**	**12**	**89**
Additional costs				
- Impairment of goodwill	33	-	-	33
- Impairment of intangible assets	-	-	-	-
- Legal and environmental costs	-	-	-	-
Total costs	**48**	**62**	**12**	**122**

The split of plans in this table has been reformatted from prior periods to reflect the relative development of the various plans.

1) Include the restructuring of the former Applied Science business and certain IT projects.

2) Include Genentech site restructuring costs and the closure of the Nutley site and associated infrastructure and environmental remediation costs.

3) Includes plan for outsourcing of clinical trial monitoring in the Pharmaceuticals Division.

Diagnostics Division

During the six months ended June 30, 2014 total costs were $25 million, mainly related to the restructuring of the former Applied Science business and certain IT projects.

Site consolidation

During the six months ended June 30, 2014 total costs were $17 million, mainly related to Genentech site restructuring. The operational closure of the site in Nutley, New Jersey, was completed on schedule by the end of 2013 and the RHI Group is currently in the process of divesting the site. Work on remediating the Nutley site is continuing, but no significant additional restructuring expenses were incurred in the first half of 2014.

Other restructuring plans

During the six months ended June 30, 2014 total costs were $21 million, mainly related to the implementation of the outsourcing of clinical trial monitoring in the Pharmaceuticals Division.

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

	Six months ended June 30, 2014	2013
Employee-related costs		
- Termination costs	28	43
- Defined benefit plans	-	-
- Other employee-related costs	1	4
Total employee-related costs	**29**	**47**
Site closure costs		
- Impairment (reversal) of property, plant and equipment	-	3
- Accelerated depreciation of property, plant and equipment	14	1
- (Gains) losses on disposal of property, plant and equipment	-	-
- Other site closure costs	1	-
Total site closure costs	**15**	**4**
Other reorganisation expenses	19	38
Total restructuring costs	**63**	**89**
Additional costs		
- Impairment of goodwill	-	33
- Impairment of intangible assets [8]	-	-
- Legal and environmental costs	-	-
Total costs	**63**	**122**

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

	Six months ended June 30, 2014			Six months ended June 30, 2013		
	Depreciation, amortisation and impairment	Other costs	Total	Depreciation, amortisation and impairment	Other costs	Total
Cost of sales						
- Pharmaceuticals	14	-	14	-	1	1
- Diagnostics	-	6	6	-	2	2
Marketing and distribution						
- Pharmaceuticals	-	-	-	-	-	-
- Diagnostics	-	9	9	-	4	4
Research and development						
- Pharmaceuticals	-	23	23	-	43	43
- Diagnostics	-	1	1	3	7	10
General and administration						
- Pharmaceuticals	-	1	1	-	26	26
- Diagnostics	-	9	9	33	2	35
- Corporate	-	-	-	-	1	1
Total	**14**	**49**	**63**	**36**	**86**	**122**
Total by operating segment						
Pharmaceuticals	14	24	38	-	70	70
Diagnostics	-	25	25	36	15	51
Corporate	-	-	-	-	1	1
Total	**14**	**49**	**63**	**36**	**86**	**122**

7. Goodwill

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

Six months ended June 30, 2014	
At January 1, 2014	5,442
Business combinations [5]	405
Impairment charge	(604)
At June 30, 2014	**5,243**
Allocation by operating segment	
Roche Pharmaceuticals	1,960
Diagnostics	3,283
Total RHI Group	**5,243**

During the six months ended June 30, 2014 the goodwill in the Tissue Diagnostics business area within the Diagnostics Division was fully written down with an impairment charge of $604 million. The impairment charge was recorded within general and administration. The factors leading to this impairment were a decrease in forecast cash flows following a change in the timelines for future product development, combined with additional U.S. reductions in immunohistochemistry testing reimbursement to laboratories and a change in the pre-tax discount rate used for impairment testing to 11.9% at June 30, 2014 compared to 11.2% in 2013. In addition impairments of $173 million were recorded for product intangibles in the Tissue Diagnostics business (see Note 8).

8. Intangible assets

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

	Product intangibles: in use	Product intangibles: not available for use	Technology intangibles: in use	Total
Six months ended June 30, 2014				
At January 1, 2014	1,297	1,311	51	2,659
Business combinations [5]	237	253	-	490
Additions	9	47	-	56
Disposals	-	(8)	-	(8)
Transfers	-	-	-	-
Amortisation charge	(141)	-	(4)	(145)
Impairment charge	(173)	(64)	-	(237)
At June 30, 2014	**1,229**	**1,539**	**47**	**2,815**
Allocation by operating segment				
Pharmaceuticals	499	486	45	1,030
Diagnostics	730	1,053	2	1,785
Total RHI Group	**1,229**	**1,539**	**47**	**2,815**

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

	Amortisation		Impairment	
	2014	2013	2014	2013
Cost of sales				
- Pharmaceuticals	(37)	(35)	-	-
- Diagnostics	(89)	(79)	(173)	-
Research and development				
- Pharmaceuticals	(19)	(22)	(64)	(239)
- Diagnostics	-	-	-	-
Total RHI Group	**(145)**	**(136)**	**(237)**	**(239)**

Impairment charges - 2014

Pharmaceuticals Division. Impairment charges totalling $64 million were recorded which related to:

- A decision to stop development of a compound acquired as part of a previous business combination ($36 million). The asset concerned, which was not yet being amortised, was fully written down.
- A decision to stop development of a compound with an alliance partner ($28 million). The asset concerned, which was not yet being amortised, was fully written down.

Diagnostics Division. Impairment charges totalling $173 million were recorded which related to Tissue Diagnostics product intangibles. The factors leading to this impairment were a decrease in forecast cash flows following a change in the timelines for future product development, combined with additional U.S. reductions in immunohistochemistry testing reimbursement to laboratories and a change in the asset specific pre-tax discount rate used for impairment testing to 12.5% at June 30, 2014 compared to 11.7% in 2013. The assets concerned, which were being amortised, were written down to their estimated recoverable value of $147 million.

Impairment charges – 2013

Pharmaceuticals Division. Impairment charges totalling $239 million were recorded which related to:

- A portfolio reassessment within the hepatitis C virus (HCV) franchise ($215 million). The assets concerned, which were not yet being amortised, were written down to their recoverable value of $63 million.
- A decision to stop two projects in collaboration with alliance partners ($20 million). The assets concerned, which were being amortised, were fully written down.
- A decision to stop development of one compound with an alliance partner ($4 million). The asset concerned, which was not yet being amortised, was fully written down.

9. Provisions and contingent liabilities

Provisions *in millions of USD*

	June 30, 2014	December 31, 2013
Legal provisions	617	633
Environmental provisions	344	360
Restructuring provisions	174	217
Employee provisions	209	190
Other provisions	1,066	801
Total provisions	**2,410**	**2,201**
Current	1,734	1,766
Non-current	676	435
Total provisions	**2,410**	**2,201**

During the six months ended June 30, 2014 a total of $289 million of provision were utilised (six months ended June 30, 2013: $310 million), mainly related to the utilisation of restructuring and sales return provisions.

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

Accutane. The litigation related to Accutane is described in Note 19 to the Annual Financial Statements. Since January 1, 2014 there have been 131 cases dismissed in the U.S. At June 30, 2014 Hoffmann-La Roche Inc. was defending approximately 7,480 actions involving approximately 7,590 plaintiffs. The RHI Group continues to defend vigorously the remaining personal injury cases and claims.

Tarceva subpoena. On November 2, 2011 Genentech received a subpoena from the United States Department of Justice, requesting documents and information related to the promotion of Tarceva, a prescription product initially approved for the treatment of locally advanced or metastatic non-small cell lung cancer after failure of at least one prior chemotherapy regimen, and later approved for additional indications. Genentech is cooperating with the associated investigation which is both civil and criminal in nature. On May 6, 2014 government representatives presented for the first time the government's civil liability theory, specifically that Genentech allegedly participated in the off-label promotion of Tarceva causing the submission of false claims for reimbursement under the Civil False Claims Act. Genentech currently plans to respond to the government's presentation in the second half of 2014. The outcome of this matter cannot be determined at this time.

PDL litigation. The litigation and arbitration between PDL Biopharma and Genentech/Roche is described in Note 19 to the Annual Financial Statements. On January 31, 2014 the parties agreed to a settlement that resolves all of the disputes between them. Under the settlement agreement, PDL agreed to dismiss all of its claims against Genentech and Roche. In return Genentech agreed to pay PDL a single fixed royalty rate until the end of 2015. All of these matters are now concluded.

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

10. Debt

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

Six months ended June 30, 2014	
At January 1, 2014	33,594
Proceeds from issue of bonds and notes	-
Redemption and repurchase of bonds and notes	(1,925)
Increase (decrease) in commercial paper	2,079
Increase (decrease) in amounts due to related parties	400
Increase (decrease) in other debt	(11)
Net (gains) losses on redemption and repurchase of bonds and notes [3]	142
Amortisation of debt discount [3]	9
Net foreign exchange (gains) losses	(25)
At June 30, 2014	**34,263**
Bonds and notes	13,124
Commercial paper	2,870
Amounts due to related parties	18,080
Finance lease obligations	189
Total debt	**34,263**
Long-term debt	25,168
Short-term debt	9,095
Total debt	**34,263**

Foreign currency transaction gains of $25 million are mainly related to the stronger U.S. dollar compared to the euro and occurred in Roche Holdings, Inc., which is the issuer of most of the outstanding bonds and notes. These gains were recorded in the income statement, where they have been partially offset by losses on the hedging derivatives.

Currency swaps. The proceeds of all of the European Medium term Note program and all Swiss franc-denominated bonds were swapped into U.S. dollars by entering into derivative contracts with related parties. The related party derivatives mirror exactly the terms of derivative contracts that a Roche Group affiliate outside of the RHI Group has entered with third party financial institutions. As a result, in these financial statements, the bonds and notes have economic characteristics equivalent to U.S. dollar-denominated bonds and notes.

Issuance of bonds and notes

The RHI Group did not issue any bonds or notes during the six months ended June 30, 2014 or June 30, 2013.

Redemption and repurchase of bonds and notes – 2014

Partial repurchase of pound sterling-denominated notes. On February 28, 2014 the RHI Group completed a tender offer to repurchase 419 million pounds sterling 5.5% fixed rate notes due March 4, 2015. The cash outflow was $735 million, plus accrued interest and there was a loss on repurchase of $35 million. The effective interest rate of these notes was 5.70%.

Partial redemption of U.S. dollar-denominated notes. On December 26, 2013 the RHI Group resolved to exercise its option to call for early partial redemption of U.S. dollar-denominated 6.0% fixed rate notes due March 1, 2019. On March 3, 2014 the RHI Group redeemed an outstanding principal of $1,000 million at an amount equal to the sum of the present values of the remaining scheduled payments of these notes discounted to the redemption date at the U.S. Treasury rate plus 0.50%, together with accrued and unpaid interest on the principal. The cash outflow was $1,190 million, plus accrued interest and there was an additional $17 million loss recorded on redemption. The effective interest rate of these notes was 6.37%.

Partial redemption of U.S. dollar-denominated notes in August 2014. On June 30, 2014 the RHI Group resolved to exercise its option to call for early partial redemption of U.S. dollar-denominated 6.0% fixed rate notes due March 1, 2019. The RHI Group will redeem an outstanding principal of $500 million on August 29, 2014 at an amount equal to the sum of the present values of the remaining scheduled payments of these notes discounted to the redemption date at the U.S. Treasury rate plus 0.50%, together with accrued and unpaid interest on the principal. The U.S. Treasury rate will be determined by an independent investment banker. A cash outflow of approximately $586 million, plus accrued interest, is expected on redemption. The RHI Group has revised the carrying value of these notes to take into account the changes to the amounts and timings of the estimated cash flows. The increase in carrying value of $90 million is recorded within financing costs (see Note 3) as a loss on redemption. The effective interest rate of these notes is 6.37%.

Redemption and repurchase of bonds and notes – 2013

During the six months ended June 30, 2013 the RHI Group redeemed 3.3 billion euros of notes ($4.3 billion) on their due date and completed the early redemption of $1.8 billion of notes.

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

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

	Six months ended June 30,	
	2014	2013
European Medium Term Note programme euro-denominated notes	-	(4,314)
European Medium Term Note programme pound sterling-denominated notes	(735)	-
U.S. dollar-denominated notes	(1,190)	(1,822)
Total cash outflows from redemption and repurchase of bonds and notes	**(1,925)**	**(6,136)**

Commercial paper

Roche Holdings, Inc. commercial paper program. Roche Holdings Inc. has an established commercial paper program under which it can issue up to $7.5 billion of unsecured commercial paper notes guaranteed by Roche Holding Ltd. A committed credit line of 3.9 billion euros is available as a back-stop line. The maturity of the notes under the program cannot exceed 365 days from the date of issuance. At June 30, 2014 unsecured commercial paper notes with a principal amount of $2.9 billion and an average interest rate of 0.10% were outstanding.

Movements in commercial paper obligations *in millions of USD*

Six months ended June 30, 2014	
At January 1, 2014	791
Net cash proceeds (payments)	2,079
At June 30, 2014	**2,870**

Recognised liabilities due to related parties

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

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

Six months ended June 30, 2014	
At January 1, 2014	17,680
Cash inflows from related parties	4,450
Cash outflows to related parties	(4,050)
At June 30, 2014	**18,080**

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

Cash inflows from related parties *in millions of USD*

	Six months ended June 30,	
	2014	2013
Term note 2.39% issued March 14, 2014	800	-
Term note 4.55% issued January 6, 2014	875	-
Term note 2.27% issued January 6, 2014	875	-
Term note 4.38% issued March 3, 2014	1,000	-
Term note 4.38% issued March 14, 2014	500	-
Term note 2.49% issued June 24, 2014	400	-
Total	**4,450**	-

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

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

	Six months ended June 30,	
	2014	2013
Term note 5.52% due March 14, 2014	(800)	-
Term note 2.25% due March 14, 2014	(500)	-
Term note 1.99% due January 6, 2014	(1,750)	-
Term note 3.04% due March 3, 2014	(1,000)	-
Total	**(4,050)**	-

11. Equity attributable to RHI shareholder

Genentech transaction

The RHI Group completed the purchase of the non-controlling interest in Genentech effective March 26, 2009. Based on the International Accounting Standard 27 'Consolidated and Separate Financial Statements' (IAS 27) and consistent with the International Financial Reporting Standard 10 'Consolidated Financial Statements' (IFRS 10), which was adopted by RHI in 2013, this transaction was accounted for in full as an equity transaction. As a consequence, the carrying amount of the consolidated equity of the RHI Group at that time was reduced by $46.6 billion, of which $7.6 billion was allocated to eliminate the book value of Genentech non-controlling interest. At June 30, 2014 the RHI Group had a negative equity of $22.3 billion (December 31, 2013: $20.9 billion). The capacity of the RHI Group to generate positive cash flows and operating profit is not affected by this accounting treatment.

Share capital

At June 30, 2014 the share capital of Roche Holdings, Inc., which is the RHI Group's parent company, consisted of 1,000 shares with a nominal value of $1,000 each and has not changed during the first half of 2014. All shares are indirectly owned by Roche Holding Ltd., a public company registered in Switzerland.

Dividends

On January 14, 2014 the Board of Directors of RHI resolved to declare a dividend of $1 million per share to RHI's sole stockholder, Roche Finance Ltd, which has been paid in the first half of 2014. On March 11, 2014 the Board of Directors of RHI resolved to declare a dividend of $1 million per share to RHI's sole stockholder, Roche Finance Ltd, which has been paid in the first half of 2014. On May 28, 2014 the Board of Directors of RHI resolved to declare a dividend of $0.5 million per share to RHI's sole stockholder, Roche Finance Ltd, of which $0.4 million per share has been paid in the first half of 2014.

Own equity instruments

The RHI Group holds none of its own equity shares.

Retained earnings

In addition to net income attributable to the RHI shareholder of $1,969 million (six months ended June 30, 2013: $2,617 million) and the dividend payments described above, retained earnings also includes losses on remeasurements of defined benefit plans of $85 million, after tax (six months ended June 30, 2013: gains of $296 million, after tax). These were based on updated actuarial calculations for major plans and the losses were mainly due to a decrease in the discount rate since the end of 2013.

12. Financial risk management

The RHI Group's financial risk management objectives and policies are consistent with those disclosed in Note 26 to the Annual Financial Statements.

Fair value hierarchy

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

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

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

	Level 1	Level 2	Level 3	Total
At June 30, 2014				
Marketable securities - equity securities	515	-	-	515
Derivative financial instruments – related parties [13]	-	513	-	513
Available-for-sale investments – held at fair value	5	25	-	30
Financial assets recognised at fair value	**520**	**538**	**-**	**1,058**
Derivative financial instruments	-	(355)	-	(355)
Contingent consideration	-	-	(321)	(321)
Financial liabilities recognised at fair value	**-**	**(355)**	**(321)**	**(676)**

At June 30, 2014 Level 1 financial assets consist of treasury bills, bonds and quoted shares. Level 2 financial assets consist primarily of commercial paper, certificates of deposit and derivative financial instruments.

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

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

The RHI Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the transfer has occurred. There were no significant transfers between Level 1 and Level 2 during the six months ended June 30, 2014.

Level 3 fair values

Details of the determination of Level 3 fair value measurements and the transfer out of Level 3 of the fair value hierarchy during the six months ended June 30, 2014 are set out below.

Contingent consideration arrangements *in millions of USD*	
Six months ended June 30, 2014	
At January 1, 2014	(67)
Arising from business combination [5]	(278)
Total unrealised gains and losses included in the income statement	
- Unused amounts reversed	-
- Additional amounts created	-
- Discount unwind	(1)
Transfers out of Level 3	
- Utilised [5]	25
At June 30, 2014	**(321)**

Contingent consideration arrangements

The RHI Group is party to certain contingent consideration arrangements arising from business combination arrangements. The fair value is determined considering the expected payment, discounted to present value using a risk-adjusted discount rate. The expected payments are determined by considering the possible scenarios of forecast sales or other performance criteria, the amount to be paid under each scenario, and the probability of each scenario. The significant unobservable inputs are the forecast sales or other performance criteria and the risk-adjusted discount rate. The estimated fair value would increase if the forecast sales or other performance criteria rate was higher or the risk-adjusted discount rate was lower. At June 30, 2014 the payments under contingent consideration arrangements could be up to $630 million (December 31, 2013: $255 million). The contingent consideration arrangements mainly relate to the acquisitions of Constitution Medical Investors, Inc. (2013), Genia Technologies, Inc. (2014) and IQuum, Inc. (2014).

Carrying value and fair value

At June 30, 2014 the carrying value of bonds and notes is $13.1 billion compared to a fair value of $16.0 billion and the carrying value of total debt is $34.3 billion compared to a fair value of $37.1 billion. The carrying values of financial assets are a reasonable approximation of the fair values at June 30, 2014.

13. Related parties

Controlling shareholder

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

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

Related party transactions *in millions of USD*

	Six months ended June 30,	
	2014	2013
Sales	809	697
Royalty income	1,185	1,104
Contract revenue	212	383
Purchases of inventory and other materials	(288)	(376)
Reimbursements received under research and development cost-sharing and collaboration agreements	407	421
Payments issued under research and development cost-sharing and collaboration agreements	(474)	(388)
Financing costs – related parties		
Interest expense	(337)	(346)
Guarantee fees	(50)	(64)
Total financing costs – related parties	**(387)**	**(410)**
Other financial income (expense) – related parties		
Net gains (losses) on foreign currency derivatives	(3)	(67)
Other financial income (expense)	1	3
Total other financial income (expense) – related parties	**(2)**	**(64)**

Related party balances *in millions of USD*

	June 30,2014	December 31, 2013
Other current assets	-	2
Accounts receivable	2,325	2,650
- of which derivative financial assets [12]	*513*	*595*
Total receivable – related parties	**2,325**	**2,652**
Long-term debt	(13,280)	(13,130)
Short-term debt	(4,800)	(4,550)
Total debt – related parties	**(18,080)**	**(17,680)**
Other non-current liabilities	(588)	(306)
Other current liabilities	(1,963)	(1,732)
Accounts payable	(861)	(745)
- of which derivative financial liabilities	-	-
Total payable – related parties	**(3,412)**	**(2,783)**

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

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Review Report of the Independent Auditor to the Board of Directors of

Roche Holdings, Inc., Wilmington, Delaware

Introduction

We have been engaged to review the accompanying consolidated condensed balance sheet of Roche Holdings, Inc.as at June 30, 2014 and the related consolidated statements of income and comprehensive income, condensed statement of cash flows and statement of changes in equity for the six-month period then ended, and selected explanatory notes (the interim consolidated financial statements) on pages 6 to 23 The Board of Directors is responsible for the preparation and presentation of these interim consolidated financial statements in accordance with International Accounting Standard 34 *'Interim Financial Reporting',* as adopted by the European Union (EU). Our responsibility is to express a conclusion on these interim consolidated financial statements based on our review.

Scope of Review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim consolidated financial statements as at June 30, 2014 are not prepared, in all material respects, in accordance with International Accounting Standard 34 *'Interim Financial Reporting'* as adopted by the European Union (EU).

KPMG AG

Ian Starkey

François Rouiller

Basel, 25 July 2014