

## FINANCIAL REVIEW



"In 2007, excluding the costs of the restructuring and synergy programmes, earnings per share grew by 7% to \$4.20. The momentum in sales and profit growth established in recent years was maintained despite the introduction of generic competition to *Toprol-XL* in the US. In addition, our strong cash generation allowed us to return almost \$7 billion to our shareholders in dividends and share re-purchases.

At the same time, we took significant steps to secure and widen the platform from which continued strong performance in the future can be launched. We acquired and began integrating the leading biologics company, MedImmune, adding to our launched product portfolio, increasing our development pipeline and extending our research and development capabilities beyond small molecules to include monoclonal antibodies and vaccines. Secure medium- and long-term debt programmes have been established from which a significant portion of the financing for the acquisition of MedImmune was drawn, whilst short-term cash and borrowing facilities for our immediate commitments to our shareholders and third parties have been put in place. Restructuring initiatives, first introduced in manufacturing at the beginning of the year,

have been extended to all areas and include synergy opportunities arising from the acquisition of MedImmune. These initiatives are anticipated to deliver annual benefits of \$1,400 million from 2010.

These steps will allow for further increases in investment in research and development to strengthen and realise the pipeline, selective geographical expansion and focused exploitation of our existing products whilst continuing to generate attractive returns for our shareholders."

**SIMON LOWTH**  
Chief Financial Officer

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The purpose of this section of the Directors' Report is to provide a balanced and comprehensive analysis, including the key business factors and trends, of the financial performance of the business during 2007, the financial position as at the end of the year and the main business factors and trends which could affect the future financial performance of the business.

### MEASURING PERFORMANCE

As described on page 10, we use specific measures when assessing our performance in key areas and include them in our discussion throughout the Directors' Report.

Reported performance takes into account all the factors (including those which we cannot influence, principally currency exchange rates) that have affected the results of our business as reflected in our Financial Statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union and as issued by the International Accounting Standards Board.

Some of the financial measures use information derived at constant exchange rates (CER), in particular, growth rates in sales and costs, operating profit and, as a consequence, earnings per share.

> Underlying growth using constant exchange rates is defined as a non-GAAP measure because, unlike actual growth, it cannot be derived directly from the information in the Financial Statements. This measure removes the effects of currency movements (by retranslating the current year performance at previous year's exchange rates and adjusting for other exchange effects, including hedging) which allows us to focus on the changes in sales and expenses driven by volume, prices and cost levels relative to the prior period.

> Sales and cost growth expressed in CER allows management to understand the true local movement in sales and costs, in order to compare recent trends and relative return on investment. CER growth rates can be used to analyse sales in a number of ways but, most often, we consider underlying growth by products and groups of products, and by countries and regions. Underlying sales growth can be further analysed into the impact of sales volumes and selling price. Similarly, CER cost growth helps us to focus on the real local change in costs so that we can manage the cost base effectively.

> Earnings per share growth in CER demonstrates not only the profitability of the business (based on profit after tax) but also the management of our capital structure (particularly through the share re-purchase programme).

> In addition, during 2007, we acquired the biologics company MedImmune and instigated a series of major Senior Executive Team-approved restructuring and synergy programmes. Both of these factors have significantly affected our results and make growth rates, both on a reported and underlying basis, and comparison to 2006 more difficult to analyse. Accordingly, in this review, we show various growth and financial measures (such as sales, operating profit and earnings per share) adjusted for

## FINANCIAL REVIEW CONTINUED

the effects of the Senior Executive Team-approved restructuring and synergy costs and the acquisition of MedImmune so as to analyse more transparently the progress of our business.

- > We recognise that these CER growth measures and the measures adjusted for the effects of the Senior Executive Team-approved restructuring and synergy costs and the acquisition of MedImmune should not be used in isolation and, accordingly, we also discuss the comparable GAAP actual growth measures (reported performance), which reflect all the factors that affect our business in the reported performance sections of this report.

Other measures used are not influenced so directly, or indeed at all, by the effects of exchange rates:

- > Gross margin and operating profit margin percentages, which set out the progression of key performance margins and demonstrate the overall quality of the business. We also present these percentages excluding the effects of MedImmune and restructuring and synergy costs to isolate the progression of these percentages driven by the previous recurring business.
- > Prescription volumes and trends for key products, which can represent the real business growth and the progress of individual products better and more immediately than invoiced sales.
- > Net debt, representing our interest bearing loans and borrowings less cash and cash equivalents and current investments.
- > Total shareholder return measures the returns we provide to our shareholders and reflects share price movements assuming reinvestment of dividends and is used in comparison to the performance of peer group companies.

#### BUSINESS BACKGROUND AND MAJOR EVENTS AFFECTING 2007

The business background is covered in the Business Environment section on page 13 and describes in detail the developments in both our products and geographical regions. The following comments highlight how these and other factors affect our financial performance.

Our operations are focused on prescription pharmaceuticals, and over 97% of our sales are made in that sector. Sales of pharmaceutical products are directly influenced by medical needs and are generally financed by health insurance schemes or national healthcare budgets.

Our operating results in both the short and long term can be affected by a number of factors other than normal competition:

- > The risk of generic competition following loss of patent exclusivity or patent expiry, with the potential adverse effects on sales volumes and prices, for example, the launch of generic competition to *Toprol-XL* 25mg in November 2006 and other strengths in 2007.
- > The timings of new product launches, which can be influenced by national regulators and the risk that such new products do not succeed as anticipated.
- > The rate of sales growth and costs following new product launches.
- > The adverse impact on pharmaceutical prices as a result of the regulatory environment. For instance, although there is no direct governmental control on prices in the US, action from individual state programmes and health insurance bodies are leading to downward pressures on realised prices. In other parts of the world, there are a variety of price and volume control mechanisms and retrospective rebates based on sales levels that are imposed by governments.
- > Currency fluctuations. Our functional and reporting currency is the US dollar, but we have substantial exposures to other currencies, in particular the euro, Japanese yen, sterling and Swedish krona.

Over the longer term, the success of our R&D is crucial, and we devote substantial resources to this area. The benefits of this investment emerge over the long term and inherently there is considerable uncertainty as to whether it will generate future products.

The most significant features of our financial results in 2007 are as follows:

- > Overall sales growth on an underlying basis of 7% (12% reported) to \$29,559 million.
- > Sustained strong sales performances from our five key products (which now account for just under 52% of sales) of

\$15,344 million, an increase of 11% on an underlying basis (15% reported).

- > Operating profit of \$8,094 million, an underlying decrease of 4% (1% reported). After adjusting for the impact of MedImmune and restructuring and synergy costs, operating profit increased by 10% on an underlying basis (12% reported) with an operating margin improvement of 1.0 percentage points to 32.0%.
- > Investment in R&D through the income statement has increased by an underlying 24% (32% reported) to \$5,162 million. This rise reflects further increases in underlying activity as well as the acquisition of MedImmune and the collaboration with Bristol-Myers Squibb.
- > Earnings per share decline on an underlying basis of 5% (3% reported) to \$3.74. After adjusting for the impact of MedImmune and restructuring and synergy costs, earnings per share growth of 15% (17% reported) to \$4.52.
- > Net cash from operating activities of \$7,510 million, compared with \$7,693 million in 2006.
- > Total cash distributions to shareholders of \$6,811 million, up from \$6,367 million in 2006.
- > The move from a net funds position at the beginning of the year of \$6,537 million to a net debt position of \$9,112 million, driven by the acquisition of MedImmune.
- > The acquisition and integration of MedImmune with effect from 1 June 2007.
- > The commencement of a number of restructuring initiatives across all areas of the business.
- > Ten projects in phase III development.
- > The introduction of generic competitors to all strengths of *Toprol-XL* in the US. Excluding US contribution of *Toprol-XL* and authorised generic (sales of \$969 million in 2007 and \$1,382 million in 2006, earnings per share of \$0.39 in 2007 and \$0.50 in 2006), our sales growth was 10% (14% reported) and earnings per share decline was 3% (flat as reported).