

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).