

# FINANCIAL REVIEW



"In 2008, sales increased by 3%, with sales growth driven by our key brands, the addition of MedImmune and the strong performance of Emerging Markets businesses which grew at 16%. Core operating margin increased by 1.6 percentage points in constant currency terms, as a result of improved efficiencies throughout the organisation and delivery of our restructuring initiatives. The improved Core operating margin translated 3% sales growth for the year into a 9% increase in Core operating

profit and an 8% increase in Core earnings per share to \$5.10.

Cash generation was strong in 2008; cash from operating activities increased by over \$1.2 billion, driven principally by an increase in earnings before interest, tax, depreciation and amortisation (EBITDA) and reduced working capital outflows. This enabled us to make the payment to Merck as part of the planned phased exit arrangements, invest in capital and intangible assets to drive future business growth and productivity and fund a 10% increase in the full year dividend, whilst at the same time reducing our net debt by more than \$1.9 billion to \$7.2 billion at the end of 2008. This strong performance puts us well ahead of our plan to reduce net debt to \$7 billion by the end of 2010.

We recently announced an expanded scope for our restructuring programme to drive further improvements in our long-term competitiveness. Overall, the programme is now anticipated to deliver \$2.1 billion in annual savings by the end of 2010 (up from \$1.4 billion), reaching \$2.5 billion per annum by 2013. The restructuring costs to deliver these benefits are now expected to be \$2.9 billion (up from \$2 billion).

Our continued efforts to drive efficiencies throughout the business, combined with a strong focus on converting growth in EBITDA into cash, should ensure resilient financial performance as we face an increasingly challenging external environment."

**SIMON LOWTH**  
Chief Financial Officer

The purpose of this Financial Review is to provide a balanced and comprehensive analysis of the financial performance of the business during 2008, 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.

All growth rates in this section are expressed at constant exchange rates (CER) unless noted otherwise.

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## MEASURING PERFORMANCE

The following measures are referred to when reporting on our performance both in absolute terms but more often in comparison to earlier years in this section of the Directors' Report:

- > Reported performance. 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 (IFRSs) as adopted by the European Union (EU) and as issued by the International Accounting Standards Board.
- > Core financial measure. This is a non-GAAP measure because unlike reported performance it cannot be derived directly from the information in the Group's Financial Statements. This measure is adjusted to exclude certain significant items, such as charges and provisions related to restructuring and synergy programmes, amortisation and the impairment of the significant intangibles arising from corporate acquisitions and those related to our current and future exit arrangements with Merck in the US, and other specified items. See page 34 for a reconciliation of Core to reported performance.

- > Constant exchange rate (CER) growth rates. CER is also a non-GAAP measure. This measure removes the effects of currency movements (by retranslating the current year's performance at previous year's exchange rates and adjusting for other exchange effects, including hedging). A reconciliation to reported performance is provided on page 33.
- > Gross margin and operating profit margin percentages, which set out the progression of key performance margins and demonstrate the overall quality of the 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.

We believe that Core financial and growth measures allow us to analyse more transparently the progress of our business. Our recent reported results have been impacted by the global restructuring and synergy programmes together with impacts arising from corporate acquisitions.

Accordingly, in this Financial Review, we show financial and growth measures adjusted for the effects of these items. For 2008, we adjust for the effects of the restructuring and synergy costs, amortisation and impairment charges recorded against MedImmune and amortisation arising on the historic arrangements with Merck.

CER measures allow 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 CER growth by products and groups of products, and by countries and regions. CER 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.

We recognise that CER growth rates and Core financial measures should not be used in isolation and, accordingly, we also discuss comparative reported growth measures that reflect all the factors that affect our business.

#### BUSINESS BACKGROUND AND MAJOR EVENTS AFFECTING 2008

The business background is covered in the Business Environment section of this Directors' Report and describes in detail the developments in both our products and geographical regions.

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 paid for by health insurance schemes or national healthcare budgets. Our operating results can be affected by a number of factors other than the delivery of operating plans and normal competition:

- > 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.
  - > The risk of generic competition following loss of patent exclusivity or patent expiry or an 'at risk' launch by a competitor, with the potential adverse effects on sales volumes and prices, for example, the launch of generic competition to both *Ethylol* and *Pulmicort Respules* in 2008 and *Toprol-XL* in 2006.
  - > 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, together with the rate of sales growth and costs following new product launches.
  - > 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.
  - > Macro factors such as greater demand from an ageing population and increasing requirements of servicing Emerging Markets.
- 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 there is considerable inherent uncertainty as to whether and when it will generate future products.
- The most significant features of our financial results in 2008 are:
- > Reported sales of \$31,601 million, representing CER sales growth of 3% (7% reported).
  - > Strong performance in Emerging Markets with CER sales growth of 16% (20% reported).
  - > Continued strong performance from our five key products (*Arimidex*, *Crestor*, *Nexium*, *Seroquel* and *Symbicort*) with sales of \$17,110 million, up 9% at CER on prior year sales (12% reported).
  - > Operating profit increased by 4% at CER (13% reported). Core operating profit increased by 9% at CER.
  - > Earnings per share: \$4.20, an increase of 2% at CER (12% reported). Core earnings per share were \$5.10, an increase of 8% at CER.
  - > Net cash inflow from operating activities increased to \$8,742 million (2007: \$7,510 million).
  - > The partial retirement of Merck's interests in certain AstraZeneca products in the US took place on 17 March 2008 through a \$2.6 billion net payment to Merck.
  - > Cash distributions to shareholders were \$3,349 million (2007: \$6,811 million) through dividend payments of \$2,739 million (2007: \$2,641 million) and share re-purchases of \$610 million (2007: \$4,170 million).
  - > Net debt decreased to \$7,174 million (2007: \$9,112 million), a reduction of \$1,938 million.
  - > Total restructuring and synergy costs associated with the global programme to reshape the cost base of the business, were \$881 million in 2008 (2007: \$966 million). This brings the total costs incurred to date to \$1,847 million.

### RESULTS OF OPERATIONS – SUMMARY ANALYSIS OF YEAR TO 31 DECEMBER 2008

The tables on this page and the following page show our sales analysed by therapy area, operating profit for 2008 compared to 2007 and a reconciliation of reported operating profit to Core operating profit for 2008 and 2007.

Sales increased by 7% on a reported basis and by 3% on a CER basis. Currency benefited reported sales by 4%. More details on our sales performance by therapy area are given on pages 53 to 70, in the sections titled 'Performance 2008'.

Core gross margin of 80.4% in the year was 0.8 percentage points higher than last year at CER (Reported: 79.1%: 0.8 percentage points higher). Principal drivers were lower payments to Merck (1.0 percentage points), continued efficiency gains and mix factors (1.2 percentage points), partially offset by higher royalty payments (0.6 percentage

points) and intangible asset impairments and other provisions (0.8 percentage points).

Core R&D costs of \$4,953 million were down 1% at CER over last year (Reported: 0%). The inclusion of a full year of MedImmune expense was offset by improved productivity and efficiency, restructuring benefits, portfolio changes and lower charges relating to intangible asset impairments charged to Core R&D expense.

Core SG&A costs of \$9,940 million were up 3% at CER (Reported: up 4%) due chiefly to the inclusion of a full year of MedImmune costs, increased investment in our Emerging Markets and some higher legal expenses.

Core other income of \$734 million was \$6 million higher than last year (Reported: decreased \$204 million) with MedImmune's licensing and royalty income streams offset by expected lower one-time gains and royalty income.

Impairment charges relating to intangible fixed assets totalled \$631 million during the year. Charges totalling \$407 million, including impairments in respect of *Ethyol* and HPV vaccines, have been excluded from Core operating profit. Charges totalling \$224 million, including \$115 million in respect of *Pulmicort Respules*, have been included in Core operating profit. Full details are provided on page 35.

Core operating profit was up 9% at CER from 2007 (Reported: up 13%). CER Core operating margin increased by 1.6 percentage points to 34.7% of sales as improvements in gross margin were offset by higher SG&A costs. Reported operating profits, at 28.9%, increased by 1.5 percentage points as a result of improvements in gross margin and R&D efficiencies which more than offset a modest increase in SG&A costs.

Net finance expense was \$463 million compared to \$111 million for 2007.

### SALES BY THERAPY AREA (2008 AND 2007)

	2008			2007		2008 compared to 2007	
	Reported \$m	CER growth \$m	Growth due to exchange effect \$m	Reported \$m	CER growth %	Reported growth %	
Cardiovascular	6,963	29	248	6,686	–	4	
Gastrointestinal	6,344	(275)	176	6,443	(4)	(2)	
Infection and other <sup>1</sup>	2,451	706	31	1,714	41	43	
Neuroscience	5,837	346	151	5,340	6	9	
Oncology	4,954	(109)	244	4,819	(2)	3	
Respiratory and Inflammation	4,128	278	139	3,711	7	11	
Other businesses	924	54	24	846	6	9	
<b>Total</b>	<b>31,601</b>	<b>1,029</b>	<b>1,013</b>	<b>29,559</b>	<b>3</b>	<b>7</b>	

<sup>1</sup> Includes *Synagis* and *FluMist* which were acquired in June 2007.

### OPERATING PROFIT (2008 AND 2007)

	2008			2007		Percentage of sales		2008 compared to 2007	
	Reported \$m	CER growth \$m	Growth due to exchange effect \$m	Reported \$m	Reported 2008 %	Reported 2007 %	CER growth %	Reported growth %	
Sales	31,601	1,029	1,013	29,559			3	7	
Cost of sales	(6,598)	38	(217)	(6,419)	(20.9)	(21.7)	(1)	3	
Gross profit	25,003	1,067	796	23,140	79.1	78.3	5	8	
Distribution costs	(291)	(39)	(4)	(248)	(0.9)	(0.8)	16	17	
Research and development	(5,179)	(88)	71	(5,162)	(16.4)	(17.5)	2	–	
Selling, general and administrative costs	(10,913)	(433)	(116)	(10,364)	(34.6)	(35.1)	4	5	
Other operating income and expense	524	(188)	(16)	728	1.7	2.5	(26)	(28)	
<b>Operating profit</b>	<b>9,144</b>	<b>319</b>	<b>731</b>	<b>8,094</b>	<b>28.9</b>	<b>27.4</b>	<b>4</b>	<b>13</b>	
Net finance expense	(463)			(111)					
Profit before tax	8,681			7,983					
Taxation	(2,551)			(2,356)					
<b>Profit for the period</b>	<b>6,130</b>			<b>5,627</b>					
Earnings per share	4.20			3.74					

Growth rates on line items below operating profit, where meaningful, are given elsewhere in this Report.

The increase in interest expense was driven by additional borrowings arising as a result of the acquisition of MedImmune in 2007. Our exposure to interest costs was reduced in 2008, from the closing position in 2007, as we moved debt used to finance the purchase of MedImmune from short-term, higher interest rate commercial paper, to longer-term debt financing at lower interest rates. The 2008 net finance expense benefited from a net fair value gain of \$130 million relating to two long-term bonds due to widening credit spreads. We anticipate that the fair value gain will largely reverse as credit markets stabilise.

The effective tax rate was 29.4% (2007: 29.5%).

Core earnings per share were \$5.10, an increase of 8% at CER on 2007, as the increase in Core operating profit and the benefit of a lower number of shares outstanding was partially offset by increased net finance expense. Reported earnings per share increased 12% to \$4.20.

#### GEOGRAPHICAL ANALYSIS

We discuss the geographical performances in the Geographic Review on pages 48 to 52.

#### FINANCIAL POSITION, INCLUDING CASH FLOW AND LIQUIDITY – 2008

All data in this section is on a reported basis (unless noted otherwise).

Total net assets increased by \$1,145 million to \$16,060 million. The increase due to Group profit of \$6,101 million was offset by dividends of \$2,767 million and net share re-purchases of \$451 million. Exchange movements arising on consolidation and actuarial losses also reduced net assets during the year.

#### RECONCILIATION OF REPORTED RESULTS TO CORE RESULTS

2008	Reported \$m	Restructuring and synergy costs \$m	MedImmune amortisation \$m	<i>Ethylol</i> and other impairments <sup>1</sup> \$m	Merck amortisation \$m	2008 Core \$m
Gross profit	25,003	405	–	–	–	25,408
Distribution costs	(291)	–	–	–	–	(291)
Research and development	(5,179)	166	–	60	–	(4,953)
Selling, general and administrative costs	(10,913)	310	307	257	99	(9,940)
Other operating income and expense	524	–	120	90	–	734
<b>Operating profit</b>	<b>9,144</b>	<b>881</b>	<b>427</b>	<b>407</b>	<b>99</b>	<b>10,958</b>
Net finance expense	(463)	–	–	–	–	(463)
Profit before tax	8,681	881	427	407	99	10,495
Taxation	(2,551)	(259)	(125)	(121)	–	(3,056)
<b>Profit for the period</b>	<b>6,130</b>	<b>622</b>	<b>302</b>	<b>286</b>	<b>99</b>	<b>7,439</b>
Earnings per share	4.20	0.43	0.21	0.19	0.07	5.10

  

2007	Reported \$m	Restructuring and synergy costs \$m	MedImmune amortisation \$m	<i>Ethylol</i> and other impairments \$m	Merck amortisation \$m	2007 Core \$m
Gross profit	23,140	415	–	–	–	23,555
Distribution costs	(248)	–	–	–	–	(248)
Research and development	(5,162)	73	–	–	–	(5,089)
Selling, general and administrative costs	(10,364)	478	255	–	96	(9,535)
Other operating income and expense	728	–	–	–	–	728
<b>Operating profit</b>	<b>8,094</b>	<b>966</b>	<b>255</b>	<b>–</b>	<b>96</b>	<b>9,411</b>
Net finance expense	(111)	–	–	–	–	(111)
Profit before tax	7,983	966	255	–	96	9,300
Taxation	(2,356)	(285)	(75)	–	–	(2,716)
<b>Profit for the period</b>	<b>5,627</b>	<b>681</b>	<b>180</b>	<b>–</b>	<b>96</b>	<b>6,584</b>
Earnings per share	3.74	0.46	0.12	–	0.06	4.38

  

2007 to 2008	Core \$m	CER growth \$m	Growth due to exchange effect \$m	Core \$m	CER growth %	Total core growth %
Gross profit	25,408	1,057	796	23,555	5	8
Distribution costs	(291)	(39)	(4)	(248)	16	17
Research and development	(4,953)	71	65	(5,089)	(1)	(3)
Selling, general and administrative costs	(9,940)	(289)	(116)	(9,535)	3	4
Other operating income and expense	734	23	(17)	728	3	1
<b>Operating profit</b>	<b>10,958</b>	<b>823</b>	<b>724</b>	<b>9,411</b>	<b>9</b>	<b>16</b>
Net finance expense	(463)	–	–	(111)	–	–
Profit before tax	10,495	–	–	9,300	–	–
Taxation	(3,056)	–	–	(2,716)	–	–
<b>Profit for the period</b>	<b>7,439</b>	<b>–</b>	<b>–</b>	<b>6,584</b>	<b>–</b>	<b>–</b>
Earnings per share	5.10	–	–	4.38	–	–

<sup>1</sup> Includes \$150 million of impairments against intangible assets, acquired with MedImmune, relating to the return of rights to the heat shock protein 90 (Hsp90) drug candidates IPI-504 (MEDI-561) and the IPI-493 to Infinity Pharmaceuticals and revised forecasts for future royalties related to HPV vaccines. Also included is a \$257 million impairment charge for *Ethylol* following the 'at risk' launch of a generic competitor.

On 17 March, AstraZeneca paid \$2.6 billion to Merck. This payment resulted in AstraZeneca acquiring Merck's interests in certain AstraZeneca products including *Pulmicort*, *Rhinocort*, *Symbicort* and *Toprol-XL* and has been included in intangible assets as explained below.

#### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment fell by \$1,255 million to \$7,043 million primarily due to depreciation and impairments of \$1,182 million and exchange movements of \$1,131 million offset by additions of \$1,113 million.

#### GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangibles have increased by \$846 million to \$22,197 million.

The main components within goodwill are the amounts capitalised on acquisition of MedImmune of \$8,757 million and on the restructuring of our US joint venture with Merck in 1998. No significant amounts have been capitalised within goodwill in 2008. The total goodwill balance has reduced by \$10 million due to exchange rate movements.

Intangible assets have increased by \$856 million to \$12,323 million. Additions totalled \$2,941 million, amortisation was \$807 million and impairments totalled \$631 million. Exchange reduced intangibles by \$603 million.

Additions to intangible assets in 2008 included a payment made to Merck under pre-existing arrangements under which Merck's interests in our products in the US will be terminated (subject to the exercise of certain options). \$994 million of this payment relates to certain specific AstraZeneca products, including *Pulmicort*, *Rhinocort*, *Symbicort* and *Toprol-XL*. As a result of the payment AstraZeneca no longer has to pay contingent payments on these products to Merck and has obtained the ability to fully exploit these products and to fully exploit other opportunities in the Respiratory therapy area that AstraZeneca was previously prevented from doing by Merck's interests in these products. The remainder of the payment (\$1,656 million) represents payments on account for the product rights that will crystallise if we exercise options in 2010. Further details of this are included in Note 25 to the Financial Statements.

In March, a \$257 million intangible asset impairment charge was taken as a result of the entry of generic *Ethyol*, a product capitalised on the acquisition of MedImmune,

into the US market. The settlement of the *Pulmicort Respules* patent litigation triggered an impairment of \$115 million. The remaining impairments arise as a result of the termination of projects in development and a charge for \$91 million relating to the reassessment of the licensing income expected to be generated by the HPV cervical cancer vaccine.

Reported performance includes impairments in respect of *Ethyol*, HPV and other projects in development (principally the return of rights to Infinity Pharmaceuticals) which management believe are not part of Core performance. As a result, management has adjusted for impairments totalling \$407 million in presenting Core performance.

#### INVENTORIES

Inventories have decreased by \$483 million to \$1,636 million due to exchange movements of \$298 million along with an underlying reduction in inventory of \$185 million.

#### RECEIVABLES, PAYABLES AND PROVISIONS

Trade and other receivables increased by \$593 million to \$7,261 million. Exchange rate movements reduced receivables by \$429 million. The underlying increase of \$1,022 million was driven by increased sales in our Emerging Markets, the extension of major credit terms in the UK and increased insurance recoverables.

Trade and other payables increased by \$130 million, or \$675 million after removing the impacts of exchange rate movements, primarily due to increases in US managed market accruals. Trade payables include \$2,136 million in respect of accruals relating to rebates and reductions in our US market. These are explained and reconciled fully on pages 43 and 44.

Provisions increased by \$122 million driven mainly by increases in specific insurance and long-term provisions.

#### TAX PAYABLE AND RECEIVABLE

Net income tax payable has increased by \$667 million to \$1,968 million principally due to tax audit provisions and cash tax timing differences. Net deferred tax liabilities have decreased mainly as a result of the impact of actuarial losses suffered in the year, the amortisation and impairment of MedImmune intangibles and exchange benefits.

#### RETIREMENT BENEFIT OBLIGATIONS

Net retirement benefit obligations increased by \$734 million principally as a result of actuarial losses of \$1,232 million offset by exchange benefits of \$434 million. Approximately 95% of the Group's obligations are concentrated

in three countries. The following table shows the dollar effect of a 1% change in the discount rate on the obligations in those countries.

	-1%	+1%
UK (\$m)	739	(640)
US (\$m)	226	(199)
Sweden (\$m)	333	(263)

#### COMMITMENTS AND CONTINGENT LIABILITIES

Contingent liabilities principally relate to litigation including litigation relating to employment, product liability, commercial disputes, infringement of intellectual property rights, the validity of certain patents, anti-trust, securities laws and governmental investigations.

Most of the claims involve highly complex issues. Often, these issues are subject to substantial uncertainties and therefore the probability of a loss, if any, being sustained and an estimate of the amount of any loss are difficult to ascertain. Consequently, for a majority of these claims, it is not possible to make a reasonable estimate of the expected financial effect, if any, that will result from ultimate resolution of the proceedings. In these cases, AstraZeneca discloses information with respect to the nature and facts of the case.

Although there can be no assurance regarding the outcome of any of the legal proceedings, based on management's current and considered view of each situation, we do not currently expect them to have a materially adverse effect on our financial position. This position could of course change over time.

Assessments as to whether or not to recognise provisions or assets and of the amounts concerned usually involve a series of complex judgements about future events and can rely heavily on estimates and assumptions. AstraZeneca believes that the provisions recorded are adequate based on currently available information and that the insurance recoveries recorded will be received.

However, given the inherent uncertainties involved in assessing the outcomes of these cases and in estimating the amount of the potential losses and the associated insurance recoveries, we could in future periods incur judgements or insurance settlements that could have a material adverse effect on our results in any particular period.

Details of the more significant matters are set out in Note 25 to the Financial Statements.

**NET DEBT**

	2008 \$m	2007 \$m
Cash and short-term investments	6,044	7,760
Loans and borrowings	(15,156)	(1,223)
<b>Net (debt)/funds brought forward at 1 January</b>	<b>(9,112)</b>	<b>6,537</b>
Earnings before interest, tax, depreciation, amortisation and impairment	11,764	9,950
Movement in working capital	(210)	(443)
Tax paid	(2,209)	(2,563)
Interest paid	(690)	(335)
Other non-cash movements	87	901
<b>Net cash available from operating activities</b>	<b>8,742</b>	<b>7,510</b>
Purchase of intangibles	(2,944)	(549)
Other capital expenditure (net)	(1,057)	(1,076)
Acquisitions	-	(14,891)
<b>Investments</b>	<b>(4,001)</b>	<b>(16,516)</b>
Dividends	(2,739)	(2,641)
Net share re-purchases	(451)	(3,952)
<b>Distributions</b>	<b>(3,190)</b>	<b>(6,593)</b>
Other movements	387	(50)
<b>Net debt carried forward at 31 December</b>	<b>(7,174)</b>	<b>(9,112)</b>
Comprised of:		
Cash and short-term investments	4,674	6,044
Loans and borrowings	(11,848)	(15,156)

**CASH FLOW**

Cash generated from operating activities was \$8,742 million in the year, compared with \$7,510 million in 2007. The increase of \$1,232 million was principally driven by an increase in operating profit before depreciation, amortisation and impairment costs of \$1,814 million, a decrease in tax payments of \$354 million and lower working capital outflows of \$233 million, offset by an increase in interest payments of \$355 million and a decrease in non-cash items of \$814 million which includes movements on provisions.

Net cash outflows from investing activities were \$3,896 million in the year compared with \$14,887 million in 2007.

Cash distributions to shareholders were \$3,349 million through dividend payments of \$2,739 million and share re-purchases of \$610 million.

During the year we issued a further €500 million, 5.625% 18-month bond as part of our re-financing programme, the proceeds of which have been used to re-finance maturing commercial paper.

Gross debt (including loans, short-term borrowings and overdrafts) was \$11,848 million as at 31 December 2008 (2007: \$15,156 million). Of this debt, \$993 million is due within one year (2007: \$4,280 million)

which we currently anticipate repaying from current cash balances of \$4,286 million and business cash flows, without the need to re-finance.

Net debt of \$7,174 million has decreased by \$1,938 million from 31 December 2007.

We continue to believe that, although our future operating cash flows are subject to a number of uncertainties, as specified in the Business Background section on page 32, our cash and funding resources will be sufficient to meet our forecasting requirements, including developing and launching new products, externalisation, our ongoing capital programme, our restructuring programme, debt servicing and repayment and shareholder distributions.

**RESTRUCTURING AND SYNERGY COSTS**

In 2008 we continued the global restructuring and synergy programmes announced in 2007. Costs for the full year totalled \$881 million (of which \$219 million are non-cash items).

This annual total reflects an extension in the scope of the previously announced \$1,975 million programme. New initiatives include further rationalisation of the global supply chain, additional restructuring of the sales and marketing organisation and business infrastructure.

When fully implemented, these and other new business reshaping activities, combined with revised estimates for the original 2007 programme, will result in the overall programme delivering a reduction of approximately 15,000 positions by 2013. Reductions in positions are subject to consultations with works councils, trade unions and other employee representatives and in accordance with local labour laws.

As a result of the expanded scope of these business reshaping programmes, total programme charges for restructuring and synergies are now estimated to reach \$2,950 million. When fully implemented, programme benefits are now estimated to reach \$2.5 billion per annum.

**CAPITALISATION AND SHAREHOLDER RETURN**

All data in this section is on a reported basis.

**CAPITALISATION**

The total number of shares in issue at 31 December 2008 was 1,447 million. 4.1 million shares were issued in consideration of share option plans and employee share plans for a total of \$159 million. Reserves were reduced by \$2,277 million in 2008 due to the effect of exchange rates and actuarial losses. Shareholders equity increased by a net \$1,134 million to \$15,912 million at the year end. Minority interests increased to \$148 million (2007: \$137 million).

**DIVIDEND AND SHARE RE-PURCHASES**

In line with the Board's distribution policy and its overall financial strategy to strike a balance between the interests of the business, shareholders and financial creditors, whilst maintaining strong investment grade credit rating, total share re-purchases in 2008 were 13.6 million shares at a total cost of \$610 million. This represented 0.9% of the share capital at the start of the year. All shares re-purchased have been cancelled. This brings the total number of shares re-purchased to date since the beginning of the re-purchase schemes in 1999, to 376.3 million shares at a total cost of \$18,099 million. The Board has decided that no share re-purchases will take place in 2009 in order to maintain the flexibility to invest in the business.

In the year, 4.1 million shares were issued in consideration of share option exercises for a total of \$159 million.

The Board regularly reviews its shareholder returns strategy, and in 2008 reaffirmed the dividend policy, which is to grow dividends in line with reported earnings before restructuring and synergy costs, with an aim to maintain at least two times dividend cover.

**DIVIDEND FOR 2008**

	\$	Pence	SEK	Payment date
First interim dividend	0.55	27.8	3.34	15 September 2008
Second interim dividend	1.50	104.8	12.02	16 March 2009
<b>Total</b>	<b>2.05</b>	<b>132.6</b>	<b>15.36</b>	

**SUMMARY OF SHAREHOLDER DISTRIBUTIONS**

	Shares re-purchased (million)	Cost \$m	Dividend per share \$	Total dividend cost \$m	Total shareholder distributions \$m
1999	4.4	183	0.700	1,242	1,425
2000	9.4	352	0.700	1,236	1,588
2001	23.5	1,080	0.700	1,225	2,305
2002	28.3	1,190	0.700	1,206	2,396
2003	27.2	1,154	0.795	1,350	2,504
2004	50.1	2,212	0.940	1,555	3,767
2005	67.7	3,001	1.300	2,068	5,069
2006	72.2	4,147	1.720	2,649	6,796
2007	79.9	4,170	1.870	2,740	6,910
2008	13.6	610	2.050	2,971 <sup>1</sup>	3,581 <sup>1</sup>
<b>Total</b>	<b>376.3</b>	<b>18,099</b>	<b>11.475</b>	<b>18,242</b>	<b>36,341</b>

<sup>1</sup> Total dividend cost estimated based upon number of shares in issue at 31 December 2008.

**FUTURE PROSPECTS**

The Company has set its financial targets for 2009 in anticipation of the normal range of risks and opportunities typical for the pharmaceutical sector together with the turmoil in the financial markets and the broader economy. Management believes that successful execution of its business plan, underpinned by the underlying financial and operating strength of the Company, will result in achievement of a resilient financial performance even in this challenging business climate.

## RESULTS OF OPERATIONS – SUMMARY ANALYSIS OF YEAR TO 31 DECEMBER 2007

Core measures, as used in our commentary above on the financial results for 2008 (including comparison to 2007), are not referred to in the analysis of operating margin and profit for 2007 detailed below as this measure was introduced for 2008. Where appropriate, when comparing 2007 reported performance to 2006, the impact of the acquisition of MedImmune in 2007 is analysed to provide a more appropriate comparison between the two years.

The tables below show our sales by therapy area and operating profit for 2007 compared to 2006.

### REPORTED PERFORMANCE

Our 2007 sales increased by 12% from \$26,475 million to \$29,559 million, an increase reflecting both the acquisition of MedImmune and the entry of generic competition on all strengths of *Toprol-XL* in the US, as well as general business performance. Operating profit for 2007 fell by 1%, again reflecting the impacts of MedImmune and *Toprol-XL* together with restructuring and synergy

costs. Earnings per share for 2007 were \$3.74, a 3% decline from \$3.86 in 2006.

### PERFORMANCE – CER GROWTH RATES

#### Sales

Sales for 2007 increased 7%. The contribution to sales growth in 2007 from the acquisition of MedImmune more than offset the decline from *Toprol-XL* in the US. 2007 sales in the US were up 7%, and this was broadly similar to sales growth in the market if *Toprol-XL* and the impact of MedImmune were excluded. Sales outside the US were up 8%, comprising growth of 5% in Established Markets and 17% in the Emerging Markets.

For the second year, our portfolio in 2007 had 11 brands with annual sales greater than \$1 billion. The combined sales of our key products (*Arimidex*, *Crestor*, *Nexium*, *Seroquel* and *Symbicort*) grew by 11% in 2007 to \$15,344 million, and accounted for about 52% of our turnover.

Details on our 2007 sales performance by therapy area are given on pages 53 to 70, in the section for each individual therapy area titled 'Performance 2007'.

### GEOGRAPHICAL ANALYSIS

2007 sales by major region are included in the performance table on page 49 of the Geographical Review.

Sales in the US were \$13,366 million in 2007 (up 7%). In the US, sales of *Nexium*, *Seroquel*, *Crestor* and *Arimidex* were \$8,364 million, almost 63% of total US sales. *Symbicort* was launched in the US in the year with sales of \$50 million. Sales in Canada were \$1,145 million for 2007 (up 5%).

Sales in the rest of the world were \$15,048 million in 2007 (up 8%). Key products (*Crestor*, *Symbicort*, *Seroquel* and *Arimidex*) were up 20%. Latin America, Middle East and Africa, and Asia Pacific were up 18%. Spain and the UK had sales growths of 7% and 8% respectively. Sales in Germany continued to be impacted by doctors being encouraged to prescribe generics in 2006 and were down 3%. Sales growth of 11% was achieved in Japan in 2007.

## SALES BY THERAPY AREA (2007 AND 2006)

	2007			2006		2007 compared to 2006	
	Reported \$m	CER growth \$m	Growth due to exchange effects \$m	Reported \$m	CER growth %	Reported growth %	
Cardiovascular	6,686	292	276	6,118	5	9	
Gastrointestinal	6,443	(379)	191	6,631	(6)	(3)	
Infection and other	1,714	779	60	875	89	96	
Neuroscience	5,340	484	152	4,704	10	14	
Oncology	4,819	359	198	4,262	8	13	
Respiratory and Inflammation	3,711	369	191	3,151	12	18	
Others	846	79	33	734	11	15	
<b>Total</b>	<b>29,559</b>	<b>1,983</b>	<b>1,101</b>	<b>26,475</b>	<b>7</b>	<b>12</b>	

## OPERATING PROFIT (2007 AND 2006)

	2007			2006		Percentage of sales		2007 compared to 2006	
	Reported \$m	CER growth \$m	Growth due to exchange effects \$m	Reported \$m	2007 %	2006 %	CER growth %	Reported growth %	
Sales	29,559	1,983	1,101	26,475			7	12	
Cost of sales	(6,419)	(703)	(157)	(5,559)	(21.7)	(21.0)	13	15	
Gross margin	23,140	1,280	944	20,916	78.3	79.0	6	11	
Distribution costs	(248)	(7)	(15)	(226)	(0.8)	(0.9)	3	10	
Research and development	(5,162)	(944)	(316)	(3,902)	(17.5)	(14.7)	24	32	
Selling, general and administrative costs	(10,364)	(843)	(425)	(9,096)	(35.1)	(34.4)	9	14	
Other operating income and expense	728	188	16	524	2.5	2.0	36	39	
<b>Operating profit</b>	<b>8,094</b>	<b>(326)</b>	<b>204</b>	<b>8,216</b>	<b>27.4</b>	<b>31.0</b>	<b>(4)</b>	<b>(1)</b>	

**OPERATING MARGIN AND RETAINED PROFIT**

Operating profit for 2007 was \$8,094 million, down 4% at CER. Excluding restructuring and synergy costs of \$966 million, 2007 operating profit increased to \$9,060 million (up 8% on 2006 at CER). This operating profit improvement was net of a reported \$1,187 million increase in R&D investment, and was fuelled by revenue growth, improved gross margin and lower expenditures in SG&A on a constant currency basis. Restructuring and synergy benefits of \$300 million were realised during 2007. Reported operating margin was 27.4%.

In 2007 reported gross margin decreased by 0.7 percentage points. After adjusting for the impact on gross margin of the acquisition of MedImmune (\$472 million) and restructuring and synergy costs (\$415 million), 2007 gross margin increased by 1.0 percentage points against 2006 to 80.0%. Principal drivers included reduced payments to Merck (0.7 percentage points), asset provisions booked during the prior period (0.4 percentage points) and favourable currency movements (0.2 percentage points). An adverse effect arose from increased royalty payments, which led to a 0.4 percentage point reduction.

R&D investment increased by 24% (CER growth) to \$5,162 million in 2007, 17.5% of sales, an increase of 2.8 percentage points. After adjusting for the impact of the acquisition of MedImmune (\$255 million) and restructuring and synergy costs (\$73 million), R&D expenditure was \$4,834 million in 2007, up 16% (CER growth) and 2.1 percentage points over 2006 due principally to increased activity levels and the effect of the externalisation strategy.

Selling, general and administrative costs in 2007 increased by 9% (CER growth) to \$10,364 million. After adjusting for the impact of the MedImmune acquisition (\$560 million) and restructuring and synergy costs (\$478 million) and currency impacts, SG&A costs were 2% lower than the same period in 2006, primarily as a result of operational efficiencies from our selling and marketing activities.

At \$728 million, other operating income and expense in 2007 was 36% higher than 2006. After adjusting for the impact of the MedImmune acquisition (which contributed

other income of \$169 million primarily through human papilloma virus vaccine royalty income), other income of \$559 million was \$35 million higher than 2006, as expected reductions in royalty income were more than offset by higher one-time gains and insurance recoveries.

Total charges of \$966 million were taken in respect of the restructuring and synergy programmes in 2007, of which \$723 million represent cash costs. Over the same period, productivity initiative benefits of \$250 million and synergy benefits of \$50 million have been realised.

MedImmune contributed an operating loss of \$178 million (which included amortisation costs of \$255 million) in 2007.

Net finance expense in 2007 was \$111 million in the full year (2006 income: \$327 million). The reduction from 2006 was principally attributable to the interest payable on the borrowings to acquire MedImmune, Inc. Interest expense on the new debt was \$446 million. The 2007 reported amounts include net income of \$34 million (2006: \$43 million) arising from employee benefit fund assets and liabilities reported under IAS 19 'Employee Benefits'.

The effective tax rate for 2007 was 29.5%, similar to the 29% for 2006. The slight increase for 2007 compared to 2006 reflected the combined effect of differences in the geographical mix of profits, the reversal of tax deductions relating to share-based payments, the reduction in the UK tax rate as applied to UK net deferred tax liabilities, and an increase in tax provisions principally in relation to global transfer pricing.

Reported earnings per share for 2007 were \$3.74 compared with \$3.86 in 2006, a decrease of 5%. After adjusting for the impact of restructuring and synergy costs, 2007 earnings per share rose from \$3.86 to \$4.20, an increase of 7%. Excluding the impact of MedImmune as well, earnings per share increased by 15% to \$4.52. The share re-purchase programme is calculated to have added 8 cents to EPS during 2007, after allowing for an estimate of interest income foregone.

## FINANCIAL POSITION, INCLUDING CASH FLOW AND LIQUIDITY – 2007

All data in this section is on an actual basis (unless noted otherwise).

The book value of our net assets decreased by \$501 million to \$14,915 million at the 2007 year end. Dividends of \$2,658 million and share re-purchases of \$4,170 million exceeded net profit of \$5,595 million, whilst net movements through other recognised income and expense (principally exchange and actuarial losses) increased net assets. The overall shape of the balance sheet was changed by the acquisition of MedImmune.

### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment rose from \$7,453 million to \$8,298 million at the end of 2007. The increase was due to continued investment across the business of \$1,169 million, particularly in R&D, the acquisition of MedImmune (\$593 million) and exchange impacts (\$350 million), offset by depreciation and impairment of \$1,182 million and disposals (\$92 million).

### GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangibles rose from \$4,204 million at the beginning of 2007 to \$21,351 million at 31 December 2007. The increase is due almost entirely to the acquisition of MedImmune. The goodwill arising on the acquisition of MedImmune amounted to \$8,757 million increasing the balance sheet total to \$9,884 million; the other major component of the carrying value of goodwill relates to the restructuring in 1998 of our joint venture arrangements with Merck.

Intangibles also increased in 2007, primarily as a result of the MedImmune acquisition, supplemented by other company acquisitions and ongoing in-licensing activities. Intangibles arising from the MedImmune acquisition comprised launched products of \$7,478 million (principally the respiratory syncytial virus (RSV) franchise, other products such as *FluMist* and *EthyoI*, together with contractual and licensing income) and in development projects amounting to \$597 million. In total, intangibles amount to \$11,467 million at the 2007 year end and, in addition to those arising from the MedImmune acquisition, include intangibles arising from the restructuring in 1998 of our joint venture arrangements

with Merck and the subsequent merger of Astra and Zeneca in 1999 (\$1,026 million), the acquisition of Cambridge Antibody Technology in 2006 (\$605 million), launched and in development product in-licensing activities (\$1,327 million) and software development costs (\$434 million).

### INVENTORIES

Inventories have decreased by \$131 million from \$2,250 million at the end of 2006 to \$2,119 million. This decrease represents an underlying improvement of \$442 million, offset by the acquisition of MedImmune and exchange effects.

### RECEIVABLES, PAYABLES AND PROVISIONS

Receivables have risen from \$5,561 million to \$6,668 million as at 31 December 2007, an increase of \$1,107 million. Higher sales in 2007, particularly in the US, Europe, China and from the impact of the MedImmune acquisition (whose sales are concentrated in the first and last quarters of the year), insurance recoveries, acquisition and exchange effects were the principal drivers, offset in part by the receipt of the second instalment in respect of the US anaesthetics business disposal in 2006.

Current payables also rose from \$6,295 million to \$6,968 million at the end of 2007. There was a small net underlying movement in trade creditors, other payables and accruals, with increases in deductions for chargebacks, rebates and returns in the US being offset by decreases in trade payables, particularly to Merck. However, exchange and the acquisition of MedImmune drove the overall balance up.

Provisions increased primarily as a result of the restructuring and synergy programmes undertaken during 2007, rising from \$366 million in 2006 to \$1,020 million at the end of 2007.

### DEBT

The acquisition of MedImmune was funded initially through drawing on a \$15 billion 364 day loan facility, which was subsequently re-financed with short-term US commercial paper. In the second half of 2007, we undertook a programme of issuing debt on the US and European markets, as follows:

### SEPTEMBER 2007

Floating rate	2009	\$650m
Fixed 5.4%	2012	\$1,750m
Fixed 5.9%	2017	\$1,750m
Fixed 6.45%	2037	\$2,750m
Fixed 5.125%	2015	€750m

### NOVEMBER 2007

Fixed 4.625%	2010	€750m
Fixed 5.75%	2031	£350m

\$750 million each of the 2012 and 2017 US dollar fixed rate debt was swapped into floating rates. As at 31 December 2007, we also had commercial paper outstanding amounting to \$4,112 million.

### TAX PAYABLE AND RECEIVABLE

Net income tax payables increased in 2007 due to tax audit provisions, less the settlement of tax on the disposal of the Humira™ royalty stream. Net deferred tax liabilities increased primarily due to the acquisition of MedImmune and the recognition of deferred tax liabilities in respect of intangible assets.

### CASH FLOW

We continued to be a highly cash-generative business. However, the cost of acquisition of MedImmune meant that our funds and debt profile changed in 2007.

Cash generated from operating activities was \$7,510 million in 2007, only slightly down on 2006 (\$7,693 million). The small decrease in operating profit was compensated for by an increase in non-cash items (\$638 million principally from unspent restructuring costs) and depreciation, amortisation and impairment (\$511 million). These compensating effects were offset by an increase in working capital requirements of \$551 million and additional tax and interest payments (\$394 million and \$265 million respectively).

Net cash outflows from investing activities were \$14,887 million in 2007 compared to \$272 million in 2006. Excluding the higher returns from movements in short term investments and fixed deposits and net disposals of non-current asset investments (\$1,280 million in 2007 compared to \$1,171 million in 2006), interest received and dividends paid by subsidiaries, cash outflow from investing activities was \$16,516 million in 2007, compared to \$1,791 million in 2006. This increase in outflow was due primarily to the acquisition of MedImmune, Inc.; other acquisitions included Arrow Therapeutics Limited, Atlantis Components Inc. and

Denics International Co. Ltd. Investment in intangible assets was at broadly similar levels to 2006, and there were significantly higher payments for property, plant and equipment through increased investment in facilities, particularly in research and development.

Cash returns in 2007 to shareholders were \$6,811 million (through share re-purchases of \$4,170 million and dividend payments of \$2,641 million), compared to \$6,367 million in 2006. After taking into account proceeds from the issue of share capital of \$218 million (2006: \$985 million), net share re-purchases rose from \$3,162 million to \$3,952 million in 2007.

Net funds of \$6,537 million at the beginning of 2007 had become net debt of \$9,112 million by the end of 2007.

#### INVESTMENTS, DIVESTMENTS AND CAPITAL EXPENDITURE

The major investment in 2007 was the acquisition of MedImmune.

On the acquisition of MedImmune, the purchase price for outstanding shares of \$13.9 billion was allocated between intangible assets of \$8.1 billion (including assets in respect of *Synagis* and motavizumab RSV franchise, *FluMist*, *Ethyo* and products in development), goodwill of \$8.8 billion and net liabilities of \$3.0 billion. This allocation, based on strict accounting requirements, does not allow for the separate recognition of valuable elements such as buyer specific synergies, potential additional indications for identified products or the premium attributable to a well established, highly regarded business in the innovative biologics market. Such elements are instead subsumed within goodwill, which is not amortised. This balance between goodwill and intangible assets results in an amortisation charge of approximately \$435 million per annum. Further details of this acquisition are included in Note 22 to the Financial Statements on page 130.

The other major company and product acquisitions in 2007 reflected our ongoing commitment to strengthening the product pipeline.

In 2007, we completed the acquisition of Arrow Therapeutics Limited at a net cost of \$143 million, strengthening our portfolio of promising anti-infective treatments and providing a technology platform in an area of research that complements our capabilities in anti-bacterials. We paid \$34 million to acquire the paediatric asthma business of

Verus Pharmaceuticals, Inc. which includes the North American rights to Captisol™-enabled budesonide solution and a proprietary albuterol formulation.

In the area of product acquisitions in 2007, we capitalised \$100 million in respect of the collaboration disclosed with Bristol-Myers Squibb (BMS) in respect of saxagliptin and dapagliflozin. A global licensing and research collaboration with Palatin Technologies Inc. to discover, develop and commercialise small molecule compounds that target melanocortin receptors for the treatment of obesity and related indications was entered into, with a \$10 million capitalised upfront payment. We have also entered a three-year research and development collaboration with Silence Therapeutics plc to discover and develop proprietary siRNA molecules primarily in the respiratory field but with the option to extend into other disease areas. The initial access fee of \$5 million was capitalised as an intangible asset and the \$10 million equity investment was capitalised as a non-current asset investment.

In respect of ongoing collaborations, we have made further milestone payments of \$20 million in 2007 in relation to the agreement with Protherics (upon the successful scale-up of the manufacturing process under the development and commercialisation agreement) and \$30 million under the agreement with POZEN (in relation to the execution of the revised agreement and recognition of successful proof of concept). We have also paid \$48 million for the last in a series of sales-based milestone payments in relation to *Zomig*.

Astra Tech acquired Atlantis Components, Inc., with its specialist CAD/CAM technology used to design and manufacture customised dental implant abutments, for \$71 million and Denics International Co. Ltd, its Japanese distributor for \$5 million. Intangible assets of \$121 million have been recognised (with associated deferred tax liability of \$48 million).

In October 2007, we decided, by mutual agreement, to end our collaboration with NPS Pharmaceuticals, Inc. to discover and develop drugs targeting metabotropic glutamate receptors (mGluRs). We have agreed to pay \$30 million to acquire NPS's assets relating to the collaboration.

In 2007, our recent focus on in-licensing opportunities with third parties resulted in additional intangible assets on the balance sheet. Should any of these products fail in development, the associated intangibles will need to be written off.

## FINANCIAL RISK MANAGEMENT

### FINANCIAL RISK MANAGEMENT POLICIES

#### Insurance

Our risk management processes are described in the Risk section on pages 74 to 82. These processes enable us to identify risks that can be partly or entirely mitigated through use of insurance. We negotiate best available premium rates with insurance providers on the basis of our extensive risk management procedures. In the current insurance market, the level of cover is decreasing whilst premium rates are increasing. Rather than simply paying higher premiums for lower cover, we focus our insurance resources on the most critical areas, or where there is a legal requirement, and where we can get best value for money. Risks to which we pay particular attention include business interruption, Directors' and Officers' liability and property damage.

#### Taxation

Tax risk management forms an integrated part of the Group risk management processes. Our tax strategy is to manage tax risks and tax costs in a manner consistent with shareholders' best long-term interests, taking into account both economic and reputational factors. We draw a distinction between tax planning using artificial structures and optimising tax treatment of business transactions, and we only engage in the latter.

#### Treasury

The principal financial risks to which the Group is exposed are those of liquidity, interest rate, foreign currency and credit. The Group has a centralised treasury function to manage these risks in accordance with Board-approved policies. Specifically, liquidity risk is managed through maintaining access to a number of sources of funding to meet anticipated funding requirements, including committed bank facilities and cash resources. Interest rate risk is managed through maintaining a debt portfolio that is weighted towards fixed rates of interest. Accordingly the Group's net interest charge is not significantly affected by changes in floating rates of interest. We do not currently hedge the impact on earnings and cash flow of changes in exchange rates, with the exception of the currency exposure that arises between booking and settlement date on non-local currency purchases and sales by subsidiaries and the external dividend, along with certain non-US dollar debt. Credit risk is managed through setting and monitoring credit limits appropriate for the assessed risk of the counterparty.

Our risk management objectives and policies are described in further detail below and in the Risk section on pages 74 to 82.

### Capital management

The capital structure of the Group consists of shareholders equity (see Note 20 on page 129), debt (see Note 14 on page 119) and cash (see Note 13 on page 119). For the foreseeable future, the Board will maintain a capital structure that supports the Group's strategic objectives through:

- > Managing funding and liquidity risk
- > Optimising shareholder return
- > Maintaining a strong investment grade rating

Funding and liquidity risk are reviewed regularly by the Board and managed in accordance with policies described below. The Board's distribution policy comprises both a regular cash dividend and, subject to business needs, a share re-purchase component. The Board regularly reviews its shareholders' return strategy, and for 2008 reaffirmed the current dividend policy, which is to grow dividends in line with reported earnings before restructuring and synergy costs, with an aim to maintain at least two times dividend cover. With respect to share re-purchases, the Board decided in quarter three that no further share re-purchases should take place in 2008 in order to maintain the flexibility to invest in the business. For the same reason, the Board has decided that no share re-purchases will take place in 2009.

The Group's current long-term credit rating is A1 by Moody's and AA- by Standard and Poor's, both with a stable outlook.

### Liquidity risk

The Board reviews the Group's ongoing liquidity risks annually as part of the planning process. The Board considers short-term requirements against available sources of funding taking into account cash flow. The Group manages liquidity risk by maintaining access to a number of sources of funding, which are sufficient to meet anticipated funding requirements. Specifically, the Group uses US commercial paper, committed bank facilities and cash resources to manage short-term liquidity and manages long-term liquidity by raising funds through the capital markets. Facilities available to the Group are detailed in Note 15 to the Financial Statements on pages 120 to 121.

### Foreign exchange

The US dollar is the Group's most significant currency. As a consequence, the Group results

are presented in US dollars and exposures are managed against US dollars accordingly.

Approximately 57% of Group external sales in 2008 were denominated in currencies other than the US dollar, while a significant proportion of manufacturing and R&D costs were denominated in sterling and Swedish krona. Surplus cash generated by business units is substantially converted to, and held centrally, in US dollars. As a result, operating profit and total cash flow in US dollars will be affected by movements in exchange rates.

This currency exposure is managed centrally based on forecast cash flows for the currencies of Swedish krona, sterling, euro, Australian dollar, Canadian dollar and Japanese yen. The impact of movements in exchange rates is mitigated significantly by the correlations which exist between the major currencies to which the Group is exposed and the US dollar. Monitoring of currency exposures and correlations is undertaken on a regular basis and hedging is subject to pre-execution approval. Except as noted below, no hedges were outstanding at the year-end.

The Group will hold debt in non-US dollar currencies to the extent that there is an underlying net investment in the same currency and therefore a net investment hedge as defined by IFRS 7, can be applied. The €500 million 2010 bond issued in 2008 was issued in euros to match investors' appetite but currency swaps were transacted to convert it into a US dollar instrument. As at 31 December 2008, after currency swaps, 4.2% of interest bearing loans and borrowings were denominated in sterling and 17.8% of interest bearing loans and borrowings were denominated in euros.

The transaction exposures that arise from non-local currency sales and purchases by subsidiaries are, where practicable, fully hedged using forward foreign exchange contracts. In addition, the Group's external dividend, which is paid principally in sterling and Swedish krona, is fully hedged from announcement to payment date.

Sensitivity analysis considering the Group's exposure to exchange rate movements is detailed in Note 16 to the Financial Statements on pages 122 to 126.

### Interest rate risk

The Group maintains a mix of fixed and floating rate debt. The portion of fixed rate debt was approved by the Board and any variation requires Board approval. A significant portion

of the long-term debt entered into in 2007 in order to finance the acquisition of MedImmune, has been held at fixed rates of interest. The Group uses interest rate swaps and forward rate agreements to manage this mix.

As at 31 December 2008, the Group held interest rate swaps with a notional value of \$2.5 billion, converting the 5.4% callable bond maturing in 2014, and the 7% guaranteed debentures payable in 2023 to floating rates and partially converting the 5.4% callable bond maturing in 2012 and the 5.9% callable bond maturing in 2017 to floating rates.

No new interest rate swaps were entered into during 2008. The majority of the Group's cash balances are held with third party fund managers with floating rates of interest being earned.

Sensitivity analysis considering the Group's exposure to interest rate movements is detailed in Note 16 to the Financial Statements on pages 122 to 126.

### Credit exposure

The Group is exposed to credit risk on financial assets, such as cash balances (including fixed deposits and cash and cash equivalents), derivative instruments, trade and other receivables. The Group is also exposed in its net asset position to its own credit risk in respect of the 2023 debentures and 2014 bonds which are accounted for at fair value through profit or loss.

During the year, the Company established a credit risk oversight group, consisting of senior members of the Finance function to monitor credit related risks and risk management processes, in response to the ongoing financial markets and economic uncertainty.

Trade receivable exposures are managed locally in the operating units where they arise and credit limits are set as deemed appropriate for the customer.

Exposure to financial counterparty credit risk is controlled by the treasury team centrally in establishing and monitoring counterparty limits, which are set according to the assessed risk of each counterparty. Centrally managed funds are invested entirely with counterparties whose credit rating is 'A' or better. During the year, funds held in money market funds have been progressively transferred to US Treasury funds, in light of the ongoing financial crisis.

External fund managers, who manage \$3.0 billion of the Group's cash, are rated AAA by Standard & Poor's.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our Financial Statements are prepared in accordance with International Accounting Standards and International Financial Reporting Standards (collectively "IFRSs") as adopted by the European Union ("adopted IFRS") and as issued by the International Accounting Standards Board and the accounting policies employed are set out under the heading 'Financial Statements – Accounting Policies' on pages 103 to 107. In applying these policies, we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. The actual outcome could differ from those estimates. Some of these policies require a high level of judgement, either because the areas are especially subjective or complex. We believe that the most critical accounting policies and significant areas of judgement and estimation are in:

- > Revenue recognition
- > Research and development
- > Goodwill and intangible assets
- > Litigation
- > Post-retirement benefits
- > Taxation
- > Share-based compensation.

**REVENUE RECOGNITION**

Revenue is recorded at the invoiced amount (excluding inter-company sales and value added taxes) less movements in estimated accruals for product returns and rebates given to managed care and other customers – a particular feature in the US but also occurring in the rest of the world. Cash discounts for prompt payment are also deducted from sales. Revenue is recognised at the point of delivery, which is usually when title passes to the customer either on shipment or on receipt of goods by the

customer depending on local trading terms. Income from royalties and from disposals of intellectual property, brands and product lines are included in other operating income.

**Rebates and chargebacks**

At the time of invoicing sales in the US, rebates and chargebacks that we expect to pay, in as little time as two weeks or as much as eight months, are estimated. These rebates typically arise from sales contracts with third party managed care organisations, hospitals, long-term care facilities, group purchasing organisations and various federal or state programmes (Medicaid "best price" contracts, supplemental rebates etc) and can be classified as follows:

- > Chargebacks, where we enter into arrangements under which certain parties, typically hospitals, the Department of Veterans Affairs and the Department of Defense, are able to buy products from wholesalers at the lower prices we have contracted with them. The chargeback is the difference between the price we invoice to the wholesaler and the contracted price charged by the wholesaler. Chargebacks are paid directly to the wholesalers.
- > Regulatory, including Medicaid and other federal and state programmes, where we pay rebates based on the specific terms of agreements in individual states which include product usage and information on best prices and average market prices benchmarks.
- > Contractual, under which entities such as third party managed care organisations, long-term care facilities and group purchasing organisations are entitled to rebates depending on specified performance provisions, which vary from contract to contract.

The effects of these deductions on our US pharmaceuticals turnover are set out below.

Accrual assumptions are built up on a product-by-product and customer-by-customer basis taking into account specific contract provisions coupled with expected performance and are then aggregated into a weighted average rebate accrual rate for each of our products. Accrual rates are reviewed and adjusted on a monthly basis. There may be further adjustments when actual rebates are invoiced based on utilisation information submitted to us (in the case of contractual rebates) and claims/invoices are received (in the case of regulatory rebates and chargebacks). We believe that we have been reasonable in our estimates for future rebates using a similar methodology to that of previous years. Inevitably, however, such estimates involve judgements on aggregate future sales levels, segment mix and the respective customer contractual performance.

Cash discounts are offered to customers to encourage prompt payment. Accruals are calculated based on historical experience and are adjusted to reflect actual experience.

Industry practice in the US allows wholesalers and pharmacies to return unused stocks within six months of, and up to 12 months after, shelf-life expiry. At point of sale, we estimate the quantity and value of goods which may ultimately be returned. Our returns accruals are based on actual experience over the preceding 12 months for established products together with market related information such as estimated stock levels at wholesalers and competitor activity. For newly launched products, we use rates based on our experience with similar products or a pre-determined percentage.

	2008 \$m	2007 \$m	2006 \$m
Gross sales	20,029	18,456	16,577
Chargebacks	(1,726)	(1,130)	(975)
Regulatory – US government and state programmes	(1,005)	(732)	(532)
Contractual – Managed care and group purchasing organisation rebates	(3,658)	(3,179)	(2,413)
Cash and other discounts	(390)	(356)	(329)
Customer returns	(48)	(18)	(46)
Other	(167)	(145)	(256)
Net sales	13,035	12,896	12,026

For products facing generic competition (such as *Ethylol* and *Toprol-XL* in the US) our experience is that we usually lose the ability to estimate the levels of returns from wholesalers with the same degree of precision that we can for products still subject to patent protection. This is because we have limited or no insight into a number of areas – the actual timing of the launch of a generic competitor following regulatory approval of the generic product (for example, a generic manufacturer may or may not have produced adequate pre-launch inventory), the pricing and marketing strategy of the competitor, the take-up of the generic and (in cases where a generic manufacturer has approval to launch just one dose size in a market of several dose sizes) the likely level of switching from one dose to another. Under our accounting policy revenue is only recognised when the amount of the revenue can be measured reliably. Our approach in meeting this condition for products facing generic competition will

vary from product to product depending on the specific circumstances.

The movements on US pharmaceuticals revenue accruals, are set out below.

The adjustments in respect of prior years benefited reported US pharmaceuticals turnover by 0.4% in 2006, and decreased turnover by 0.4% in 2007 and 0.2% in 2008.

Chargebacks increased by \$173 million compared to 2007 due primarily to increased sales activities with US Government Agencies for *Nexium* and *Crestor*. Regulatory rebates increased by \$92 million in 2008 largely as a result of increased US State supplemental rebates for our key brands. In 2008 contractual rebates increased by \$184 million compared to 2007, mainly as a result of AstraZeneca's response to increased generic and competitor pricing pressures particularly in the PPI and statin markets.

The increase in contractual rebates in 2007 was driven by the introduction into the US market of generic omeprazole, with resultant price impacts on *Nexium*.

We have Distribution Service Agreements with major wholesaler buyers, which serve to reduce the speculative purchasing behaviour of the wholesalers and reduce short-term fluctuations in the level of inventory they hold. As a result, we believe inventory movements have been neutral across the year. We track wholesaler stock levels by product, using our own, third party and wholesaler data and, where we believe such distortions occur, we disclose in the Annual Report for each product and in aggregate where shipments may be out of line with underlying prescription trends. We do not offer any incentives to encourage wholesaler speculative buying and attempt, where possible, to restrict shipments to underlying demand when such speculation occurs.

	Brought forward 1 January 2006 \$m	Provision for current year \$m	Adjustment in respect of prior years \$m	Returns and payments \$m	Carried forward at 31 December 2006 \$m
Chargebacks	185	1,001	(26)	(1,068)	92
Regulatory – US government and state programmes	601	597	(65)	(819)	314
Contractual – Managed care and group purchasing organisation rebates	420	2,367	46	(2,198)	635
Cash and other discounts	27	329	–	(327)	29
Customer returns	167	46	–	(53)	160
Other	54	256	–	(263)	47
	1,454	4,596	(45)	(4,728)	1,277

  

	Brought forward 1 January 2007 \$m	Additions in respect of MedImmune \$m	Provision for current year \$m	Adjustment in respect of prior years \$m	Returns and payments \$m	Carried forward at 31 December 2007 \$m
Chargebacks	92	2	1,115	15	(1,038)	186
Regulatory – US government and state programmes	314	69	769	(37)	(687)	428
Contractual – Managed care and group purchasing organisation rebates	635	5	3,100	79	(2,919)	900
Cash and other discounts	29	1	356	–	(348)	38
Customer returns	160	1	19	(1)	(94)	85
Other	47	–	153	–	(147)	53
	1,277	78	5,512	56	(5,233)	1,690

  

	Brought forward 1 January 2008 \$m	Provision for current year \$m	Adjustment in respect of prior years \$m	Returns and payments \$m	Carried forward at 31 December 2008 \$m
Chargebacks	186	1,745	(19)	(1,553)	359
Regulatory – US government and state programmes	428	997	8	(913)	520
Contractual – Managed care and group purchasing organisation rebates	900	3,622	36	(3,474)	1,084
Cash and other discounts	38	390	–	(389)	39
Customer returns	85	48	–	(56)	77
Other	53	167	–	(163)	57
	1,690	6,969	25	(6,548)	2,136

### Royalty income

Royalty income is recorded under other operating income in the Financial Statements. Royalties tend to be linked to levels of sales or production by a third party. At the time of preparing the Financial Statements, we may have to estimate the third party's sales or production when arriving at the royalty income to be included. These estimates, which may differ from actual sales or production, do not result in a material impact on reported other operating income.

### Sales of intangible assets

A consequence of charging all internal R&D expenditure to the income statement in the year that it is incurred (which is normal practice in the pharmaceutical industry) is that we own valuable intangible assets which are not recorded on the balance sheet. We also own acquired intangible assets which are included on the balance sheet. As a consequence of regular reviews of product strategy, from time to time we sell such assets and generate income. Sales of product lines are often accompanied by an agreement on our part to continue manufacturing the relevant product for a reasonable period (often about two years) whilst the purchaser constructs its own manufacturing facilities. The contracts typically involve the receipt of an upfront payment, which the contract attributes to the sale of the intangible assets, and ongoing receipts, which the contract attributes to the sale of the product we manufacture. In cases where the transaction has two or more components, we account for the delivered item (for example, the transfer of title to the intangible asset) as a separate unit of accounting and record revenue on delivery of that component provided that we can make a reasonable estimate of the fair value of the undelivered component. Where the fair market value of the undelivered component (for example a manufacturing agreement) exceeds the contracted price for that component we defer an appropriate element of the upfront consideration and amortise this over the performance period. However, where the fair market value of the undelivered component is equal to or lower than the contracted price for that component we treat the whole of the upfront amount as being attributable to the delivered intangible assets and recognise that part of the revenue upon delivery. No element of the contracted revenue related to the undelivered component is allocated to the sale

of the intangible asset. This is because the contracted revenue relating to the undelivered component is contingent on future events (such as sales) and so cannot be anticipated.

### RESEARCH AND DEVELOPMENT

Our business is underpinned by our marketed products and development portfolio. The R&D expenditure on internal activities to generate these products is generally charged to the income statement in the year that it is incurred. Purchases of intellectual property and product rights to supplement our R&D portfolio are capitalised as intangible assets. Such intangible assets are amortised from the launch of the underlying products and are tested for impairment both before and after launch. This policy is in line with practice adopted by major pharmaceutical companies.

### GOODWILL AND INTANGIBLE ASSETS

We have significant investments in goodwill and intangible assets as a result of acquisitions of businesses and purchases of such assets as product development and marketing rights.

For the purpose of impairment testing of goodwill, the Group is regarded as a single cash-generating unit.

The recoverable amount is based on value in use using discounted risk-adjusted projections of the Group's pre-tax cash flows over ten years, a period reflecting the average patent-protected lives of our current products. The projections include assumptions about product launches, competition from rival products and pricing policy as well as the possibility of generics entering the market. In setting these assumptions we consider our past experience, external sources of information (including information on expected increases and ageing of the populations in our Established Markets and the expanding patient population in newer markets), our knowledge of competitor activity and our assessment of future changes in the pharmaceutical industry. The 10 year period is covered by internal budgets and forecasts. Given that internal budgets and forecasts are prepared for all projections, no general growth rates are used to extrapolate internal budgets and forecasts for the purposes of determining value in use.

In arriving at value in use, we disaggregate our projected pre-tax cash flows into groups reflecting similar risks and tax effects. For each group of cash flows we use an appropriate

discount rate reflecting those risks and tax effects. In arriving at the appropriate discount rate for each group of cash flows, we adjust AstraZeneca's post-tax weighted average cost of capital (7.6% for 2008) to reflect the impact of risks and tax effects. The weighted average pre-tax discount rate we used was approximately 11%.

As a cross check, we compare our market capitalisation to the book value of our net assets and this indicates significant surplus at 31 December 2008.

No goodwill impairment was identified.

The Group has also performed sensitivity analysis calculations on the projections used and discount rate applied. The Directors have concluded that, given the significant headroom that exists, and the results of the sensitivity analysis performed, there is no significant risk that reasonable changes in key assumptions would cause the carrying value of goodwill to exceed its value in use.

Impairment reviews have been carried out on all intangibles that are in development (and not being amortised), all major intangibles acquired during the year, all intangibles that have had indications of impairment during the year and all intangibles recognised on the acquisition of MedImmune. Sales forecasts and specific allocated costs (which have both been subject to appropriate Senior Management sign off) are discounted using AstraZeneca's post-tax weighted average cost of capital.

The majority of our investments in intangible assets and goodwill arose from the restructuring of the Astra-Merck joint venture in 1998, the acquisition of MedImmune in 2007 and the payment to partially retire Merck's interests in our products in the US in 2008, and we are satisfied that the carrying values are fully justified by estimated future cash flows.

### LITIGATION

In the normal course of business, potential liabilities may arise from product-specific and general legal proceedings, from guarantees or from environmental liabilities connected with our current or former sites. Where we believe that potential liabilities have a less than 50% probability of crystallising or are very difficult to quantify reliably, we treat them as contingent liabilities.

These are not provided for but are disclosed in the Notes to the Financial Statements. Further details of these contingent liabilities are set out in Note 25 on page 144. Where it is considered more likely than not that an actual liability may crystallise, and this can be measured reliably, a provision is made. Although there can be no assurance regarding the outcome of legal proceedings, we do not currently expect them to have a materially adverse effect on our results in any particular period. We also have significant commitments that are not currently recognised in the balance sheet arising from our relationship with Merck. These are described more fully in Note 25 to the Financial Statements on page 144.

#### POST-RETIREMENT BENEFITS

We offer post-retirement benefit plans which cover many of our employees around the world. In keeping with local terms and conditions, most of these plans are 'defined contribution' in nature where the resulting income statement charge is fixed at a set level or is a set percentage of employees' pay. However, several plans, mainly in the UK (which has by far the largest single scheme), the US and Sweden, are defined benefit plans where benefits are based on employees' length of service and final salary (typically averaged over one, three or five years). The UK and US defined benefit schemes were closed to new entrants in 2000. All new employees in these countries are offered defined contribution schemes.

In applying IAS 19 'Employee Benefits', we recognise all actuarial gains and losses immediately through reserves. This methodology results in a less volatile income statement charge than under the alternative approach of recognising actuarial gains and losses over time. Investment decisions in respect of defined benefit schemes are based on underlying actuarial and economic circumstances with the intention of ensuring that the schemes have sufficient assets to meet liabilities as they fall due, rather than meeting accounting requirements. The trustees follow a strategy of awarding mandates to specialist, active investment managers which

results in a broad diversification of investment styles and asset classes. The investment approach is intended to produce less volatility in the plan asset returns.

In assessing the discount rate applied to the obligations, we have used rates on AA corporate bonds with durations corresponding to the maturities of those obligations.

In all cases, the pension costs recorded in the Financial Statements are assessed in accordance with the advice of independent qualified actuaries but require the exercise of significant judgement in relation to assumptions for future salary and pension increases, long-term price inflation and investment returns.

#### TAXATION

Accruals for tax contingencies require management to make judgements and estimates in relation to tax audit issues and exposures. Amounts accrued are based on management's interpretation of country-specific tax law and the likelihood of settlement. Tax benefits are not recognised unless the tax positions are probable of being sustained. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. All such provisions are included in creditors due within one year. Any recorded exposure to interest on tax liabilities is provided for in the tax charge.

AstraZeneca faces a number of transfer pricing audits in jurisdictions around the world and, in some cases, is in dispute with the tax authorities. These disputes usually result in taxable profits being increased in one territory and correspondingly decreased in another. Our balance sheet positions for these matters reflect appropriate corresponding relief in the territories affected. The total net accrual included in the Financial Statements to cover the worldwide exposure to transfer pricing audits is \$1,628 million, an increase of \$306 million due to a number of new audits, revisions of estimates relating to existing audits, offset by a number of negotiated settlements and exchange rate effects.

Included in the total net accrual are amounts in respect of the following transfer pricing arrangements:

- > AstraZeneca and Her Majesty's Revenue & Customs (HMRC) have made a joint referral to the UK Court in respect of transfer pricing between our UK and one of our overseas operations for the years 1996 to date as there continues to be a material difference between the Group's and HMRC's positions. An additional referral in respect of controlled foreign company aspects of the same case was made during 2008. Absent a negotiated settlement, litigation is set to commence in 2010.
- > AstraZeneca has applied for two advance pricing agreements (APAs) in relation to intra-group transactions between the UK and the US and the UK and Japan. Both APAs are being progressed through competent authority proceedings under the relevant double tax treaties.

Management continues to believe that AstraZeneca's positions on all its transfer pricing audits and disputes are robust and that AstraZeneca is adequately provided.

For transfer pricing audits where AstraZeneca and the tax authorities are in dispute, AstraZeneca estimates the potential for reasonably possible additional losses above and beyond the amount provided to be up to \$400 million; however, management believes that it is unlikely that these additional losses will arise. Of the remaining tax exposures, AstraZeneca does not expect material additional losses. It is not possible to estimate the timing of tax cash flows in relation to each outcome, however, it is anticipated that a number of significant disputes may be resolved over the next one to two years. Included in the provision is an amount of interest of \$365 million.

**PAYMENTS DUE BY PERIOD**

	Less than 1 year \$m	1-3 years \$m	3-5 years \$m	Over 5 years \$m	Total \$m
Bank loans and other borrowings	1,616	2,800	2,665	12,478	19,559
Operating leases	101	131	81	145	458
Contracted capital expenditure	332	–	–	–	332
Total	2,049	2,931	2,746	12,623	20,349

**SHARE-BASED COMPENSATION**

Through the Remuneration Committee we offer share and share option plans to certain employees as part of their compensation and benefits packages, designed to improve alignment of the interests of employees with shareholders. Costs of the plans are determined using valuation models such as Black-Scholes or a modified version of the binomial model. Valuation models require judgements to be made on inputs to the model. Further details of these are given in Note 24 to the Financial Statements.

**OFF-BALANCE SHEET TRANSACTIONS AND COMMITMENTS**

We have no off-balance sheet arrangements and our derivative activities are non-speculative. The table above sets out our minimum contractual obligations at the year end.

**OTHER ACCOUNTING INFORMATION****INTERNATIONAL ACCOUNTING TRANSITION**

On transition to using adopted IFRS in the year ended 31 December 2005, we took advantage of several optional exemptions available in IFRS 1 'First-time Adoption of International Financial Reporting Standards'. The major effects of these exemptions are detailed on page 106.

**NEW ACCOUNTING STANDARDS**

New International Financial Reporting Standards which have been issued (both adopted and not yet adopted) are discussed on pages 103 to 107.

**SARBANES-OXLEY ACT SECTION 404**

As a consequence of our listing on the New York Stock Exchange, AstraZeneca is required to comply with those provisions of the US Sarbanes-Oxley Act applicable to foreign issuers. Section 404 of this legislation requires companies annually to assess and make public statements about the quality and effectiveness of their internal control over financial reporting.

Our approach to the assessment has been to select key transaction and financial reporting processes in our largest operating units and a number of specialist areas such as financial consolidation and reporting, treasury operations and taxation so that, in aggregate, we have covered a significant proportion of each of the key line items in our Financial Statements. Each of these operating units and specialist areas has ensured that its relevant processes and controls are documented to appropriate standards, taking into account, in particular, the guidance provided by the Securities and Exchange Commission. We have also reviewed the structure and operation of our "entity level" control environment. This refers to the overarching control environment, including structure of reviews, checks and balances that are essential to the management of a well controlled business.

The Directors have concluded that our internal control over financial reporting is effective as at 31 December 2008 and the assessment is set out on page 98. KPMG Audit Plc have audited the effectiveness of internal control over financial reporting and, as noted on page 99, their report is unqualified.