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FINAL TRANSCRIPT

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Conference Call Transcript

RHHBY.PK - Roche Holding AG - 2005 Full Year Results 'Morning' Conference Call

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PRESENTATION

Operator

Morning this is the [inaudible] conference operator. Welcome to the Roche full year results and report 2005. At this time I would like to turn the conference over to Dr. Erich Hunziker, Chief Financial Officer. Please go ahead sir.

Dr. Erich Hunziker *- Roche Holding - CFO*

Thank you Bridget. Good morning ladies and gentlemen and if I look on the screen even good evening to our friends in California listening in. We are very pleased that so many of you made it at this time. Together with Bill Burns CEO Division Roche Pharma, Severin Schwan CEO Division Roche Diagnostics, Karl Mahler Head of Investor Relations and key members of our team I welcome you to the annual results 2005 telephone conference. This event starts three busy days for all of us; after this call we will have a 10 am media conference here in Basel, a 3 pm analysts' meeting in London and on Friday a 12.30 analysts' meeting in New York.

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Our comments will be based on the investors' presentation which you were able to download this morning at 7 am. I understand that some of you might have been surprised by the new format of our annual report; I hope the surprise was positive because what you may have realized is that for the first time in Roche history we have now separated the finance report to give you very concise information on the financial situation.

This afternoon our Chairman and CEO Dr Franz Humer will address the Group section. Let me just select a few of his charts for comment. If we go to chart 5 we are very pleased to see that the strategic focus on our two core businesses pharma and diagnostics is bearing fruit. Sales and profits of Roche have reached record levels, strong operating cash flows have strengthened the financial position of the Group significantly, a fact which is also reflected in the strong credit rating obtained just this morning by Standard & Poors and Moody's. An outstanding clinical and regulatory news flow as well as a promising [late stage] pipeline showed the validity of our core businesses for the years to come.

If we go to chart 6 the reporting season is not over yet, but it will be difficult for any of our peers to come close to the sales performance of Roche. Just by organic growth we have added 6 billion francs in sales.

Chart 8. This chart shows in an impressive manner that Roche has dramatically expanded its [pivotal] value. Bill and Severin will show you that in addition to this attractive variant risk diversification from a product perspective Roche has also quite unique pillar of value portfolio from a geographic point of view. We are constantly improving our market position in all key world markets.

Chart 10. This chart shows the results of the strategic process to focus on our high tech core businesses diagnostics and pharma.

Chart 11. In 2005 we worked as a team in the corporate executive committee on the project Roche 2015. On this chart you see where we want to focus in the years to come and with this I hand over to Bill Burns CEO Roche Division Pharmaceuticals.

William Burns *- Roche Holding - CEO*

Good morning ladies and gentlemen it's an absolute pleasure to take you into an overview of the year 2005. A year that for the pharmaceutical division has been one of absolute record sales and record profits.

I will start at chart 17 on the chart list. Our pharma organic growth at 25% is four times faster than the world market. If we were to look at our top 10 products or our top 20 products that group of products are growing at more than 30%. Indeed if you look down the list of the top 20 products when you get a chance you will see that there are only two products that are in decline namely Rocephin where we lost about 400 million Swiss francs from the patent expiry in Italy and in the United States, and from Dilatrend off patent in Europe.

Strong operating profit development and an improved quality of earnings as you come to see in the figures. Successful launch roll out of some of our new product activities, and a year of really outstanding clinical data in oncology.

On our development side four out of the six pivotal studies for CERA for renal anemia are completed. The remaining two are well on track and we're on track for our targeted submission to the United States and the European authorities in this year 2006. And, as you saw us submit with MabThera/Rituxan in rheumatoid arthritis and of the phase III results from Actemra from Japan the stage is set for Roche to enter a new therapeutic franchise of autoimmune diseases rheumatoid arthritis.

On chart 18 in summary you see the -- that all of these key units of the pharmaceutical division contributed to that 25% against a market at estimates between 5 to 6%. Roche pharmaceuticals at 20% local growth, Genentech at 46 and Chugai at 17 are all in significant market outperform.

We also share with you this morning that the final quarter of the year was indeed a very strong quarter for us with 34% growth. A couple of key issues here; one that on Tamiflu there was some significant invoicing, not only of the pandemic sales, but also of an early winter season in Japan and demand in America. But also many of the other products, particularly products like Herceptin experienced very strong demand as some governments start to reimbursed for the [adulant] setting of Herceptin in advance of the submission of the file. So it was in deed a strong fourth quarter.

On chart 19 we summarize the P&L for pharma division. And as you can see, the operating profit grew by 37%, so stronger than the growth in sales. Despite optically on the page you see cost of sales up 28%, two countervailing forces here; our royalties were up 48% due to some of the products we have from third parties like Tamiflu and so forth. The actual cogs, the actual operational performance of the factories showed an improvement that helped to offset that, but we still had a 28% cost of sales increase.

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For the general and administration there are a number of one time elements that are in here. The retrospective reconciliation of our settlement with Gilead, the implementation of the SAP system in Genentech, a charitable donation from Genentech, transition of the equity plans in Genentech and certain restructuring provisions for Chugai and Roche. If one was -- each one of those items on itself was worth about 2 to 3 percentage points of that growth. So if you were to adjust for that the G&A would have gone up less than the growth in sales and that organically is because of our expansion into eastern Europe with six new legal entities and the expansion of Genentech in California.

When you look on chart 20 you will see that there has been margin improvement by all of the units within the pharma division and indeed it doesn't really matter; we did share with you this change in the international accounting standards on the equity compensation plans, but really it doesn't matter whether you look at it with or without. We've moved forward and so the division closed the year with an operating profit margin of 28.4%.

Chart 21 summarizes that in each of our key franchises namely oncology, transplantation, virology and renal anemia that business, these business sectors now are 70% virtually of our sales and we're growing at 38%. If you look at our key geographies North America, Japan and Europe then 86% of our sales is coming from those territories and 26% growth. Strong market outperform in each of those areas.

Turning to just a quick look over the key products; on chart 23, MabThera/Rituxan sales now well over the 4 billion. So I think looking forward, your own peak sales expectations I'm sure will be as good a predictor as anyone's. We do revise our guidance to somewhere of the order of 5.5 billion for MabThera in oncology. And this does not yet -- we have not given guidance yet on rheumatoid arthritis. We'll do that once we see the label and what we're contending with there.

The other point for MabThera is at the close of the year, based on rather stunning data on the use of the product in the maintenance setting, with a 50% reduction in the death rate, this is the first real survival data in the indolent setting, and that was a filing to the world authorities at the end of last year. Once that's approved that is a further lever of growth for MabThera. You can see the overall penetration figures on the chart here, US and Europe blue and yellow.

On Herceptin; what you see here is an increasing growth rate, really rather stunning as the world truly salutes the data that we had on adjuvant breast cancer from the four pivotal studies presented at ASCO. This is very strong. The French government, the Canadian government, some of the eastern European governments are all already reimbursing on the product. What I can share with you is that this month we will be submitting the dossier for adjuvant both in Europe and in the United States so we do look to a fast turnaround of that so that many more ladies with breast cancer can benefit from this stunning therapy.

The TAnDEM study, the use of Herceptin with hormonal therapy, this has been much heralded. We've -- we do expect the results, but we're actually waiting on a small number of events still to take place. As you'll know, these are studies that we track on, tragically, on death. So the fact that we haven't had these triggers is actually good news for the patients. We just don't know what it means for the trial [powering] and the results, relatively small numbers, but we still expect that this year. And we've started enrolment, particularly with Asian focus, phase III in gastric cancer where we believe the drug may have utility.

Page 25, for Avastin four launches that are now rolling out as you know. Genentech had a stunning adoption in the United States, the best oncology launch ever [inaudible] view on the chart here, the success of the launch in Germany. And this is rather typical of the rollout in Europe. So we are off to a strong start, as you can see by the red bar at the top of the chart showing the quarter by quarter growth rates here. Sales are 1.7 billion and rather fast reimbursement times which have been very encouraging from the European authorities. We are preparing now the filing for non-small cell lung cancer and breast cancer both in Europe and the United States, and that will take place this year.

On chart 26 you see in a nutshell the key strategy for Avastin. Never before with an oncology product have you seen the breadth and depth of the program that we've put in place for this product; third line, second line, first line adjuvant and systematically colorectal non-small cell lung, breast cancer and so forth. This is to truly establish Avastin as backbone therapy for all major tumors and for Roche Genentech to own angiogenesis and to make sure that we are the act to beat for the followers.

On 27 -- page 27 Xeloda and Tarceva; we had a very strong year for Xeloda in principal driven by the mid year approval for adjuvant breast -- sorry, adjuvant colorectal cancer, colon cancer. We've also in the course of the year seen the first survival data of the use of Xeloda in pancreatic cancer, and this year we'll be planning on a first line metastatic colorectal cancer combination to enhance the label for the use of the drug in that area. For Tarceva off to a strong start; as you know, this has been a very strong success story in the United States and we are set to replicate that as the rollout takes place into the rest of the world.

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On page 28, on one page we try to summarize the three major brands of ours, NeoRecormon Epogin with over 2 billion in sales, 8% growth, particularly good from the pre-dialysis and oncology setting. We also saw in the course of the year in the harmonization of the labels that we got the full oncology rollout for NeoRecormon. It's only for certain cancers; we have the 30,000 unit once weekly, but that's work in progress.

For CellCept, despite a new intruder on our territory, we've kept more than 95% of the market, a 20% growth rate and some of this is within the transplant setting, but some of it is coming from an appreciation, and an increasing appreciation, and driven also by publications in the New England Journal of some of the uses of the drug in autoimmune diseases, particularly lupus.

Pegasys, 17% growth, this is a sustaining of the market share, a tickle forward actually out of Japan and a loss of a bit of market share in Japan. As we predicted to you, PegIntron and Ribavirin have come into the Japanese market ahead of the Copegus introduction from ourselves. So, there is a little bit of shift in market share there, which we will have to address later this year as Copegus is priority review with the Japanese authorities.

Page 29, another new line of attack for us this year in Boniva, sales at 86 million you may think are on the modest side, but this is absolutely on track for our goals for the year. It's -- with an exit share of 9% of prescriptions in the United States and we're at a very early stage in the rollout in Europe. Recently you will have seen that we will be enhancing the once monthly label in two directions. We've had two very good studies that show that seven -- ladies that are switched between Fosamax and Boniva, or from Boniva then on to Fosamax, when asked after the study, which one would you prefer, seven out of ten ladies said they would prefer Boniva. So that will enhance our adoption we believe in the US and elsewhere.

Also, we've just had approval in the US and recommendation for approval in Europe of a once per quarter intravenous -- small intravenous injection. This is not an infusion, this is a simple bolus injection, which also gives very strong results.

Page 30 our -- maybe -- we call it a wild card I think during the course of year. Tamiflu it has in fact been a wild card. It's also been an ace. And the sales that we have generated in the course of the year, you will see, is 1.6 billion. Of that virtually half were for pandemic government orders. The other half a strong winter season at the beginning of '05 in Japan and actually an early start to the season '06 in Japan together with, as you can see on the chart here, in quarter three in the northern hemisphere we cannot really call this seasonal sales, we just call it pharmacy sales. This was personal stockpiling during the summer as some of the worries continued and people wanted to try and store in their bathroom cabinets packs of Tamiflu.

We've had orders from more than 60 countries for the pandemic supplies. The deliveries from those countries are spread between 2005, 2006 and 2007. As you know, we've been working diligently. We've 20 plus projects, both in terms of technology transfers and so forth, to get the supply chain larger, going beyond 300 million treatments per annum. That is work in progress. And to try and help you as we look forward, it's impossible to predict what the seasonal sales will be, but what I can share with you is that we want to help you with some indicative guidance that 1.1 to 1.2 billion could be the size of the pandemic invoices for the year 2006.

So in summary, from those brands on page 31, you can see that organically in the course of this last year we've added 5.1 billion revenues to the line with nine key brands in addition to Tamiflu representing now more than half of the portfolio, and that the growth story of the year is not just Tamiflu. Tamiflu accounts for about 1.2 of the incremental revenues, but there's nearly 4 billion of incremental revenues from the breadth and strength of the other products in the rollout.

Just a couple of words on the pipeline; on chart 33 again very pleased to share with you that from the development organization the phase III programs that we show you here, all met their primary end point. And these are all fuel for growth as we move forward either plain outright now or still to come.

I mentioned earlier that we are also getting ready to enter a new area of therapy and that's rheumatoid arthritis. Summarized on page 34 you will see that with MabThera coming through this will be entering a market that as of 2003 is about 4 billion Swiss francs and sales that is predicted to grow to about 12 billion as a market with the predominant share coming from biologicals. We will be entering this market with two products, MabThera/Rituxan first of all and those people that are not responding or are intolerant to the anti -TNFs, then we will move forward into a broader phase, and we have the broader phase II programme running, and for Actemra, our anti-IL6 product which is from Osaka University in Chugai, that we've seen the completion of the phase III studies in Japan. I would just remind you that at the American College of Rheumatology we saw a stunning ACR70 so people that got 70% improvement in their symptoms, that was 47% of the people in the study. This is virtually double any previously demonstrated resulting that patient group to that high target.

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At the bottom part of the chart you see that these are the first steps with late stage agents, but we do have behind that a number of autoimmune programs that are running so we believe this could be another emerging area to stand on in the company.

Page 35, what you see here is almost a flowchart of the movement of our phase III projects; end of '04, we had 31 projects,7 of them move out of the bucket because they have now been approved. We had nothing discontinued in the course of 2005, but there are 17 trial programs entered so we end '05 with 41 in phase III.

Another busy year so us and summarized on page 36, just to give you a tracker, these are the major clinical data from the phase II, III programs that I would advise you to keep an eye on and the key filings that we will have for the year. In terms of advice, certainly we believe we can continue with double digit growth. One word of caution, given that we still have another 400 billion or so of Rocephin to wash out in the first half of the year, and that the Tamiflu supply chain strengthens in the second half of the year, we do believe that the growth rate will be stronger in the second half year than the first half year. But for the full year the guidance would be double digit growth.

And with that I would like to hand over to Severin to take you into the review of the diagnostics division.

Severin Schwan - *Roche Holding - CEO*

Thank you Bill, good morning ladies and gentlemen. 2005 has been a difficult environment for the diagnostics division, but I believe we made substantial progress in key areas. If we turn now to page 38 you can first of all see that we remain the clear number one in the global diagnostics market with a 4% growth in local currencies and 20% market share. We could retain the record level of operating profit in the previous year and in fact increased our cash flow in 2005. We come back later to this. In particular we completely renewed out Accu-Chek product portfolio in diabetes care, we also placed a record level of systems in the important segment of immunodiagnostics and finally we also entered into, for Roche completely new market segments, as DNA sequencing.

On slide 39 you can again see that with 20% market share we are far ahead of our competitors in the industry.

If we turn to page 40 you can see that all this business areas have contributed to the overall growth with 5%, except diabetes care. Diabetes care has grown under-proportionately with 3% and this is really due to one product, our Accu-Chek Advantage in blood glucose self-monitoring, in particular in the developing countries, above all in the US. This product, Accu-Chek Advantage clearly has clearly reached the peak of its life cycle and the renewal of the portfolio which only came later during the year has only partially compensated for this decline. So if we turn to page 41, you see exactly the same picture; North America down by 2% and this is due to the Accu-Chek Advantage to diabetes. You can also see this has been compensated by a solid growth in all other regions.

If you look more into the details on page 42, you can see that growth was really driven by volume. We faced tremendous price pressure in the mature market segments, in particular clinical chemistry, and if you then turn to page 43 you will see this immediately reflected in our P&L. So again topline sales growing with 4% in local currencies and operating profit stable as previous year's level. You can see the main reason maybe couldn't reflect the growth on the sales line on the bottom line is due to the cost of sales who in fact doubled at twice the rate than the sales, and again the main factor here is the price pressure in the mature segments, in particular in clinical chemistry. On top of this we had also start up costs for new production facilities and new products such as the Aviva and we also record the depreciation related to the instrument placements as part of cost of sales. So with this is record level of system placements in immunodiagnostics you also see this reflected in a higher cost of sales, but this of course should then pay back in the longer term when we get reactions on those instruments.

If you look again at profitability on page 44, then you can see operating profit was 1.7 billion on previous year level and an increase of 2% in local currencies as far as cash flow is concerned where we now contribute with 2.5 billion Swiss francs to the overall [inaudible] side of the Group. Margins as you can see on the right-hand side of the chart have come down. Operating margin is now 20.5% of sales and a margin of 30.7% of sales, and as I outlined beforehand this is due to cost of sales and in particular to the price pressure in clinical chemistry. Now what I would like to point out on this slide, however as well, is that our profitability, not only in absolute terms, but also in relative terms to sales is still far ahead of competition. You can see here on the very right for example for the EBITDA margin we're still over 10 percentage points ahead in terms of margin to our industry peers.

If we turn to page 45, you can see that it has been an extremely active year for diabetes care. We completely renewed our portfolio and I would just like to point out here one product Accu-Chek Aviva, this is the product in blood glucose self-monitoring which is actually replacing Accu-Chek Advantage. If we sum up diabetes care on page 46 you can see a moderate growth with only 3% in the glucose monitoring, again due to the transition from the Accu-Chek Advantage to the Accu-Chek Aviva. We also launched the Compact Plus; as you know unlike our competitors we

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are also active in the integrated segment where we have a one step handling device, the Accu-Chek Compact that we launched Accu-Chek Compact Plus in 2005, and we also launched outside the US the Accu-Chek Spririt, our next generation of insulin pumps.

Now in fact outside of the US this product is doing extremely well. We see solid double digit growth rates in the infusion segment, in our pump market, and as you are aware we are not yet back in the US due to the import ban by the FDA. Let me just comment on this matter; we have had the FDA inspection in both of our sites in Switzerland mid last year in July. These inspections actually went very successful; we had some minor observations which could be resolved. However, during the review process later in the year in November we received some additional technical questions. They have been answered in the meantime, but the review process is still ongoing. So, at this moment, it is not possible for me to give you a prognosis when we will be back in the US market.

If we turn to page 47 for centralized diagnostics, you can see a solid growth in immunochemistry primarily driven by the instrument placements, the aggressive program we have around the world for our Elecsys systems. Clinical chemistry has seen volume growth, but due to the price pressure an overall decline in sales of 1% in local currencies. If you take our businesses together in centralized diagnostics, which is mainly immunochemistry and clinical chemistry, then for the first time in 2005, due to the strong increase in immunochemistry, we are now also the number one in the clinical [EPS] segment in centralized diagnostics.

If we turn to page 48, you see here the two key segments in molecular diagnostics with solid growth in blood screening, actually we grew with 11%. This is mainly due to a higher volume in Japan and also some new accounts which we gained in Asia and in Europe. As far as virology is concerned, we maintained our clear market leadership in this field with an 8% growth and the key reason for that, what accelerated growth in this field, has been the introduction of fully automated systems in Europe. The Cobas AmpliPrep/Cobas TaqMan which allowed to perform a number of virology tests in an extremely efficient manner.

So if we conclude on page 49, you can see that it has been an extremely busy year for diagnostics in 2005, with a renewal in diabetes care, but also a number of important product launches in the other areas and we will see a number of innovations coming through, in particular now in the professional segments for 2006 as in central diagnostics. With this, I am confident that we can accelerate growth for 2006 and end up for the year with a growth above market.

Thank you very much, with this I hand over and give back to Erich.

Dr. Erich Hunziker - *Roche Holding - CFO*

Thanks Severin. If we go to chart 51; building on our excellent operating performance you just have heard, Roche Finance made important contributions to the further strengthening of the Group. We have significantly increased net financial income and net cash and we have strengthened the balance sheet. As a result, the Roche Group has further increased its strategic flexibility.

Chart 52. In 2005 we have continued to increase the transparency of our financial reporting. The finance report as an integral part of the annual report provides detailed information on the entrepreneurial performance of the Group. I hope when you read it through that you come across many of the questions you have asked in the past and we have concluded or decided to give you a proactive answer. So I hope, in between the call now and this afternoon meeting all of you in London you will find a wealthof information on details which is now much more transparent as may be in the past.

If you go to Chart 53. Due to the excellent operating results of our core businesses and the positive financial results, the profit from continuing businesses increased by 2 billion Swiss francs or 43%. This increase almost entirely compensated for the 2.3 billion Swiss francs income in 2004 from the divested consumer health business.

Chart 54. The clear strategic focus on our core businesses, pharma diagnostics, is showing attractive results at operating level. While our innovative products have gained market share we have kept our costs basis under control, and consequently the operating expenses are increasing at a rate below sales growth. Bill has already explained the significant increase of cost of sales, which is mainly due to royalty payments on our successful pharma products like MabThera/Rituxan, Tarceva and Tamiflu. And on the other hand we have real made progress on the productivity and improvement on our production side.

Chart 55. The Group operating margin was lifted by a strong performance of pharmaceuticals whilst diagnostics had to face a minor setback on the base of severe price erosion in key markets.

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Chart 56. The fundamental changes we have implemented over recent years means that the quality has improved significantly. Interest income is now higher than interest expenses and I think it is important for you, the risk level we are taking in this field has even gone down, so we wanted to fundamentally rebuild a position where the income from our liquid funds really is always bigger than the interest expenses. We were also quite successful in managing our ForEx exposure. You saw a small negative, but just to give you the dimension of the ForEx trade we had in this arena, this was several tens of billions Swiss francs and very well managed. Actually, the major currencies like the dollar, the euro and the yen were hit by my excellent team spot on.

If we go to Chart 57. This chart gives you a detailed overview on the exceptional items in both years and their impact to the bottom line. The increase of provision for major legal cases reflect the attitude of this management team to in general sort out major legal challenges and not to push them into the future, of course, without jeopardizing the Roche position.

Chart 58. Both core businesses, pharma and diagnostics, show a significant increases in EBITDA. Also sales have increased strongly. Net working capital has actually decreased so that we show an attractive free cash flow of 7.8 billion Swiss francs. Genentech has issued debt of 2.6 billion Swiss francs while Roche has reviewed this debt position further. In total, cash and marketable securities increased to 20.9 billion Swiss francs.

Chart 59. Based mainly on the strong operating result, the net cash position of the Group significantly strengthened.

Chart 60. Due primarily to the various active net income, equity increased further. And the same picture for Chart 61. With this strength and balance sheet Roche has significantly increased its strategic flexibility to strengthen the core businesses, pharma and diagnostics.

Coming to the Chart 62. In the last 19 years Roche has continuously increased its dividend. Based on the excellent results the Board proposes to the annual shareholder meeting of February 27, 2006 that we increase the dividend by 25% to 2.50 Swiss francs per share and [inaudible].

Chart 63. Some years ago, Roche was a conglomerate with many quite diverse businesses. During the strategic focus process we gave our investors guidance on several items like, for instance, operating margin and financial income. As to finishing the focus process; based on the significantly increased transparency in the financial field and in line with all our piers, we will from now on focus on giving earnings per share guidance. Since EPS can be calculated in many forms, our finance report gives detailed definitions and background information. And, by the way, we will have a major section of the accounting workshop this afternoon dedicated to EPS calculations.

From our point of view, the core EPS is an excellent yardstick for investors to monitor the continuous performance of the business. This definition would, for instance, exclude the special effect generated by the sales of the OTC business in 2004. From our perspective, guidance on EPS is also more challenging for Roche than, for instance, operational margin guidance since EPS, by definition, only includes the Roche share of the excellent Genentech position at net come level whereas operational margin includes the full share of Genentech's improvements.

Chart 64. Here you find the definitions of the diluted EPS and the core EPS. Chart 65. In this chart you see the results for the various EPS definition. And let me finish with the outlook on chart 66. Barring unforeseen developments we anticipate above market sales growth in both division in local currencies. We expect a continued double digit growth for pharma and for the Group. We expect sales growth will be stronger in the second half of the year than in the first. The reason for this includes the rush out of Rochephin and Copegus in the first half and the build up of Tamiflu pandemic deliveries mainly in the second half due to the significant expansion of production capacity. Our target for core EPS is to grow in line with sales.

And with this we are open for any questions you would like to raise. Can I have the first question please?

QUESTION AND ANSWER

Operator

The first question from Mr Tim Anderson, Prudential Securities. Please go ahead sir.

Tim Anderson - *Prudential Securities - Analyst*

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Thank you very much. My question to you actually relates to your cash flows and your financial strength going forward that probably increases markedly. When I look at your business across many product lines it looks very healthy and it seems like you guys are going to have significant financial flexibility to pursue other opportunities. So I 'm kind of wondering if you can tell us what your uses of cash flow are as you look out over the next few years? For example are things like corporate acquisitions a priority at all in terms in taking you into new directions?

And then on a vast -- and the uptake in Europe and the rest of the world seems to be progressing well and I'm hoping you can update us on what the discussion has been relative to the price of the drug versus the clinical utility that it provides? Has there been any pushback on that balance of price versus clinical benefit?

Dr. Erich Hunziker - *Roche Holding - CFO*

Okay thank you Tim, so I might take the first one. Yes, I tell you frankly I also addressed this to the senior management teams around the world yesterday evening in our internal presentation. I said I feel much better than three years ago; it's a good feeling if all the debtors could stand in front of you, you can pay them out and you still have something in the pot. So yes it's a good position to be.

On the other hand you have seen the core of the success of this industry is innovation and innovation has many origins. Hopefully, again [inaudible] speaking, hopefully it originates in Roche research laboratories, that's always the best. But there is also a clear experience that this is not always the case and that there is a race for innovation all over the world and, of course, it looks quite significant the amount we now have available for strategic technology acquisitions. On the other hand the prices which you have to pay for good acquisitions in this field has constantly increased, so the top priority for the years to come is actually to use this cash generated by the core businesses wisely to strengthen their medium and long term performance in the innovation setup. And with this I hand to Bill for Avastin.

William Burns - *Roche Holding - CEO*

Tim on Avastin, the rollout in Europe has been pretty fast. It's been rather encouraging to see how rapidly some of the more tricky governments like the French government or the Italian government have given us reimbursement. So I think the clinical utility and the price has not proven to be as much of a hurdle as people once thought.

Now just to remind us all, the pricing in Europe we pitched at about 20% less than the price in the United States, not because we believe less strongly in the product, but because the base line therapy based on Oxaliplaten is dramatically cheaper in Europe than it is in the United States. So in terms of looking at the health economics that was really our key driver. We still have one or two governments which are going to be tricky on the pricing front, but we just persevere because the more countries in Europe where we get approval, then that puts more pressure on the countries that haven't yet approved. So I am really encouraged by the offtake that we're seeing.

Also maybe since we're on Avastin, you may remember that the countdown for Japan looked rather long in timelines. During the course of 2005, I'll cut it short, but there were changes in the ground rules in Japan as many drugs were being seen to be available internationally and would take an undue amount of time for Japan. Bottom line is this will benefit Avastin and Tarceva where we should be submitting the dossiers in the course of 2006. So I think the stage is set for a pretty good rollout.

Tim Anderson - *Prudential Securities - Analyst*

Can you just say what those international markets are that are going to be resistant on price?

William Burns - *Roche Holding - CEO*

We should expect countries like the United Kingdom and Belgium.

Tim Anderson - *Prudential Securities - Analyst*

Okay, thank you very much.

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William Burns - *Roche Holding - CEO*

From what I'm seeing right now, but this is work in progress.

Tim Anderson - *Prudential Securities - Analyst*

Okay, thank you.

Dr. Erich Hunziker - *Roche Holding - CFO*

And maybe too, as Bill has pointed out, the success in Eastern Europe is tremendous that Bill's team is having, and in countries like Russia they're achieving price levels you wouldn't believe. The world is larger than just actually the markets where we always tend to focus on. Okay may we have the next question?

Operator

The next question is from Mr John Murphy, Goldman Sachs. Please go ahead sir.

John Murphy - *Goldman Sachs - Analyst*

Yes thanks very much indeed. Erich, two questions for you please. I wonder first if you could talk a little bit about some of the key moving parts in 2006 for the operating margin because when one looks at the outlook comment on earnings, unless you're implying that tax rates going to go up or financials are going to go negative, it seems to imply flattish margins which, of course, you said 12 months ago, but have delivered 250 basis points increase this year? When one looks at the incremental profitability just in something like pharma year on year, it looks like it's come at about a 36% margin. So I'm wondering how to reconcile all of this?

And then second, on dividend we saw a strong increase in dividend for 2005. I just wondered if you could give any dividend outlook comment, would it be in line with earnings, would you look to increase the payout ratio for example?

Dr. Erich Hunziker - *Roche Holding - CFO*

Okay, the easy one first. I think as it's written in the text the Board of Roche proposes to the annual shareholders' meeting that we go up 25% this year. If you monitor our payout ratio it's still on a conservative end, but we never have given an outlook on the dividends into the future. We have given you a nice picture into the past and I think with 19 years of growth there is no reason to believe that this growth would stop.

Of course, you can also argue from another angle and say with this runup of the share price the dividend yield is still relatively small even with this 25% increase, but I think all together if we compare it in total shareholder return, and you know exactly that's the real yardstick we put up also to measure the performance of the senior management team, also in total shareholder returns I hope last year we have not disappointed you and we will not this year.

And now we are back, of course, to the spreadsheet and to the single lines of the spreadsheet. So if you go into the finance report you get a very detailed section on the tax rate. I think it's now so transparent that you can really model it yourself and don't need any guidance any more. What you can, of course, assume is that with the continued growth of Genentech success on which we are proud and on which we congratulate our colleagues over there, with the continued increase and their by definition higher tax rate, this will drive up the mix and of course my core team at Roche has the ambition to at least counterbalance the developments by step by step reducing the Roche tax rate. So I think you have quite a clear understanding what's going on.

If we count the financial income, I've given you the key drivers which I'm focusing on. First of all we are not going to increase risk to have a maybe better return, that's clear at the moment. So this means if, of course, with the increase in liquid funds, the interest income and also with interest rates going slightly up, this should be on a good path, and on the other hand you have seen that that restructuring is already where it can be; there's almost nothing which can be repaid this year, but next year there will be the next [tranche of] [inaudible] which can go.

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So if you then go for the other elements I have made a hint in my speech that we are managing ForEx for a point landing which should be plus -- minus zero, and whether we are successful with equities like we have been this year, of course, you -- we never disclosed what this equity portfolio included, but if you then see that the SMI had a nice runup last year and our equity performance was nice last year, so it's not too difficult to predict where it came from so, but I'm not saying that this can be repeated every year.

So you also have more or less now the lines below the operating profit, and if you come up I would say -- and if we mean -- and here we have to and I'm not one to get off the hook, Karl has already warned me that you will eat me alive if I dare to make this move to go to earnings per share, but it's just in line with the whole industry and we have studied in detail all our peers and all the guidance they're giving. And I think it's now really time if we go into this valid growth period to come back in line with all our peers.

What this means for the operational situation for the two core businesses I think I hand over to Bill and just to give you some hints in this area of the development.

William Burns - *Roche Holding - CEO*

A couple of points just to bear in mind, John, as you look at it. As you can see on the charts that we're going from -- as we went into 2005 it was about 31 major phase III programs, that's now 41 major programs that have to be financed for future growth. We also have about five products that are in launch rollout. Where we had a part year in 2005 we will have a full year expenses in 2006. So those are elements. We've still got about 400 million Swiss francs of Rocephin to wash out of the system. So there's a number of different forces, but I really, having lived with a margin guidance at the second decimal place for five years forgive me I'm not going there this year.

Dr. Erich Hunziker - *Roche Holding - CFO*

Okay maybe one last point. I mean you said in a [by] sentence you said you did the same last year. But if we are very fair at the beginning of last year two things nobody could predict. We definitely could predict the patterned erosion of Rocephin and we could product our huge commitment to clinical trials. That work was sure at the beginning. Nobody could predict the huge success of several of our products in clinical trials which were actually not scheduled to deliver results in 2005 already, and nobody could actually predict that Herceptin would take off after [inaudible] the way it has done.

And other hand the second one where we didn't play around with you was definitely Tamiflu. I mean at the beginning of the year there was not a vision of how this all could develop actually in the market. We were building up in a responsible manner production capacity ahead of the market demand. But I tell you frankly, it's very nice for us to see and I hope for you too that then these two effects the unplanned upswing of the cancer portfolio based on a strong clinical data flow and on the other hand the uptake on Tamiflu was able to overcompensate the wash out all Rocephin and the expenses which were increasing.

So I hope you see that this is not that we want to be conservative, and again if you go into this core EPS thinking that if you then see that this is really only reflecting the Roche part of the improvements we're making this is actually quite an ambition yardstick. And I can tell you also in an open manner this is also how we measure the performance of the Roche management, so it's an external guidance which is also in line with the internal management yardstick, and I think that's a good development.

John Murphy - *Goldman Sachs - Analyst*

Thanks very much for the detail.

Dr. Erich Hunziker - *Roche Holding - CFO*

You're welcome. Can we get the next question please.

Operator

The next question from [inaudible]. Please go ahead.

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