

**PHARMA GROUP
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PHARMA GROUP
CONSOLIDATED BALANCE SHEETS
before appropriation of profit

<i>(€ million)</i>	<i>Note</i>	December 31, 2005	December 31, 2004 <i>(1)</i>
ASSETS			
Property, plant and equipment	D.3.	6,184	5,892
Goodwill	D.4.	30,234	28,338
Intangible assets	D.4.	30,229	33,229
Investments in associates	D.6.	2,477	2,931
Financial assets – non-current	D.7.	1,318	970
Deferred tax assets	D.14.	3,095	2,084
Non-current assets		73,537	73,444
Assets held for sale	D.8.	676	—
Inventories	D.9.	3,430	3,032
Accounts receivable	D.10.	5,021	4,454
Other current assets	D.11.	2,434	1,989
Financial assets – current	D.12.	311	648
Cash and cash equivalents	D.13.-D.17.	1,249	1,840
Current assets		13,121	11,963
TOTAL ASSETS		86,658	85,407

(1) As allowed under IFRS 3, the Group has revised certain preliminary estimates of the Group A purchase price allocation within the permitted 12-month period.

The accompanying notes are an integral part of the consolidated financial statements.

PHARMA GROUP
CONSOLIDATED BALANCE SHEETS
before appropriation of profit

(€ million)	Note	December 31, 2005	December 31, 2004 (1)
LIABILITIES & SHAREHOLDERS' EQUITY			
Equity attributable to equity holders of the company	D.15.	46,637	41,061
Minority interests	D.16	189	462
Total equity		46,826	41,523
Long-term debt	D.17.	4,750	8,654
Provisions and other non-current liabilities	D.18.	7,454	6,929
Deferred tax liabilities	D.14	12,208	13,123
Non-current liabilities		24,412	28,706
Liabilities related to assets held for sale	D.8.	259	—
Account payable and accrued expenses		3,193	2,749
Other current liabilities	D.19.	5,543	5,041
Short-term debt and current portion of long-term debt	D.17.	6,425	7,388
Current liabilities		15,420	15,178
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY		86,658	85,407

(1) As allowed under IFRS 3, the Group has revised certain preliminary estimates of the Group A purchase price allocation within the permitted 12-month period.

The accompanying notes are an integral part of the consolidated financial statements.

**PHARMA GROUP
CONSOLIDATED INCOME STATEMENTS**

(€ million)	Note	Year ended December 31, 2005	Year ended December 31, 2004
Net sales	D.34.	27,311	14,871
Other revenues		1,202	862
Cost of sales		(7,566)	(4,439)
Gross profit		20,947	11,294
Research and development expenses		(4,044)	(2,389)
Selling and general expenses		(8,250)	(4,600)
Other current operating income	D.25.	261	214
Other current operating expenses	D.26.	(124)	(38)
Amortization of intangibles		(4,037)	(1,581)
Operating income – current		4,753	2,900
Restructuring costs	D.27.	(972)	(679)
Impairment of property, plant & equipment and intangibles	D.5.	(972)	—
Other operating income and expenses	D.28.	79	205
Operating income		2,888	2,426
Financial expenses	D.29.1	(532)	(239)
Financial income	D.29.2	287	124
Income before tax and associates		2,643	2,311
Income tax expense	D.30.	(477)	(479)
Share of profit/loss of associates	D.31.	427	409
Net income		2,593	2,241
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attributable to: • Minority interests	D.32.	335	255
• Equity holders of the company		2,258	1,986
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Average number of shares outstanding (million)		1,336.5	910.3
Average number of shares after dilution (million)	D.15.9	1,346.5	914.8
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- Basic earnings per share		1.69	2.18
- Diluted earnings per share		1.68	2.17
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The accompanying notes are an integral part of the consolidated financial statements.

PHARMA GROUP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(€ million)	Share capital	Additional paid-in capital and retained earnings	Treasury shares	Stock options	Items recognized directly in equity	Cumulative translation difference	Total Group	Minority interests	Total equity
Balance at January 1, 2004 – IFRS	1,466	6,579	(2,636)	131	70	—	5,610	68	5,678
Net gains/(losses) recognized directly in equity									
• Available-for-sale financial assets	—	—	—	—	94	—	94	—	94
• Derivatives designated as hedging instruments	—	—	—	—	(10)	—	(10)	—	(10)
• Tax on items recognized directly in equity	—	—	—	—	(15)	—	(15)	—	(15)
• Movement in cumulative translation adjustment	—	—	—	—	—	(2,925)	(2,925)	(44)	(2,969)
Gains/(losses) recognized in equity	—	—	—	—	69	(2,925)	(2,856)	(44)	(2,900)
Net income for the period	—	1,986	—	—	—	—	1,986	255	2,241
Total recognized profits/(losses) for the period	—	1,986	—	—	69	(2,925)	(870)	211	(659)
Dividend paid out of 2003 earnings (€1.02 per share)	—	(731)	—	—	—	—	(731)	—	(731)
Payment of dividend and equivalents to minority shareholders	—	—	—	—	—	—	—	(242)	(242)
Issuance of shares relating to acquisition of Group A and other changes in Group structure	1,319	35,264	(1,572)	—	—	—	35,011	871	35,882
Group A stock option plans allocated to the purchase price	—	—	—	746	—	—	746	—	746
Repurchase of Group A warrants	—	—	(6)	—	—	—	(6)	—	(6)
Group merger	38	1,081	—	—	—	—	1,119	(409)	710
Share-based payment									
• Value of services obtained from employees	—	—	—	112	—	—	112	—	112
• Proceeds from disposals of treasury shares related to stock purchase options	—	—	44	—	—	—	44	—	44
Group merger	—	27	—	—	—	—	27	—	27
Other movements	—	(1)	—	—	—	—	(1)	(37)	(38)
Balance at December 31, 2004	2,823	44,205	(4,170)	989	139	(2,925)	41,061	462	41,523
Net gains/(losses) recognized directly in equity									
• Available-for-sale financial assets	—	—	—	—	23	—	23	—	23
• Derivatives designated as hedging instruments	—	—	—	—	(89)	—	(89)	—	(89)
• Tax on items recognized directly in equity	—	—	—	—	21	—	21	—	21
• Movement in cumulative translation adjustment	—	—	—	—	—	4,257	4,257	37	4,294
Gains/(losses) recognized in equity	—	—	—	—	(45)	4,257	4,212	37	4,249
Net income for the period	—	2,258	—	—	—	—	2,258	335	2,593
Total recognized profits/(losses) for the period	—	2,258	—	—	(45)	4,257	6,470	372	6,842
Dividend paid out of 2004 earnings (€1.20 per share)	—	(1,604)	—	—	—	—	(1,604)	—	(1,604)
Payment of dividend and equivalents to minority shareholders	—	—	—	—	—	—	—	(291)	(291)
Share-based payment									
• Exercise of options	8	197	—	—	—	—	205	—	205
• Proceeds from sale of treasury shares on exercise of stock purchase options	—	—	105	—	—	—	105	—	105
• Value of services obtained from employees	—	—	—	199	—	—	199	—	199
• Tax effect of exercise of options	—	—	—	60	—	—	60	—	60
Capital increase reserved for employees (excluding employee share ownership plan)	4	137	—	—	—	—	141	—	141
Reduction in share capital	(32)	(780)	812	—	—	—	—	—	—
Buyout of minority shareholders	—	—	—	—	—	—	—	(342)	(342)
Other movements	—	—	—	—	—	—	—	(12)	(12)
Balance at December 31, 2005	2,803	44,413	(3,253)	1,248	94	1,332	46,637	189	46,826

The accompanying notes are an integral part of the consolidated financial statements.

**PHARMA GROUP
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(€ million)	Note	Year ended December 31, 2005	Year ended December 31, 2004
Net income		2,258	1,986
Minority interests other than BMS (1)		36	(2)
Share of earnings of associates, net of dividend and equivalents received		170	(2)
Depreciation and amortization		5,951	2,244
Gains and losses on disposals of non-current assets (2)		(125)	(135)
Net change in deferred taxes		(2,100)	(735)
Net change in provisions		27	182
Cost of employee benefits (stock options and employee share ownership plan)		231	112
Impact of workdown of Group A inventories remeasured at fair value, net of tax		249	342
Unrealized gains and losses recognized in income statement		(60)	(5)
Operating cash flow before changes in working capital		6,637	3,987
(Increase)/decrease in inventories		(586)	162
(Increase)/decrease in accounts receivable		(738)	11
Increase/(decrease) in accounts payable and accrued expenses		474	537
Net change in other current assets, financial assets (current) & other current liabilities		611	(648)
Net cash provided by operating activities (3)		6,398	4,049
Acquisitions of property, plant & equipment and intangibles	D.3 - D.4	(1,143)	(754)
Acquisition of Group A, net of cash acquired	D.1	—	(14,343)
Acquisitions of investments in consolidated undertakings, net of cash acquired		(692)	(29)
Acquisitions of available-for-sale financial assets		(4)	—
Proceeds from disposals of property, plant and equipment, intangibles and other non-current assets (4)		733	965
Net change in loans and other non-current financial assets		5	(12)
Net cash used in investing activities		(1,101)	(14,173)
Issuance of Group shares	D.15	314	—
Dividends paid:			
• to Group shareholders		(1,604)	(731)
• to minority shareholders other than BMS (1)		(10)	(4)
Additional long-term borrowings	D.17	5,268	5,504
Repayments of long-term borrowings	D.17	(7,959)	(646)
Net change in short-term borrowings	D.17	(2,099)	5,090
Acquisitions and disposals of treasury shares		105	9
Net cash provided by/(used in) financing activities		(5,985)	9,222
Impact of exchange rates on cash and cash equivalents		97	(23)
Net change in cash and cash equivalents		(591)	(925)
Cash and cash equivalents, beginning of period		1,840	2,765
Cash and cash equivalents, end of period		1,249	1,840

(1) See Note C1 (i)

(2) Including available-for-sale financial assets

(3) Including in 2005

taxes paid:	2,669
interest paid:	471
dividends received:	4
interest received:	76

(4) Property, plant and equipment, intangible assets and investments in consolidated undertakings

The accompanying notes are an integral part of the consolidated financial statements.

PHARMA GROUP
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended December 31, 2005

INTRODUCTION

Pharma Group ("the Group") is a leading global pharmaceuticals group engaged in the development, manufacture and marketing of healthcare products in seven major therapeutic fields: cardiovascular, thrombosis, oncology, metabolic disorders, central nervous system, internal medicine and vaccines. Our international R&D effort provides a platform for us to develop leading positions in our markets.

We have production facilities in all continents.

On August 20, 2004, the Group acquired control of Group A, which has been included in the consolidated financial statements since that date. For a description of the main effects of the acquisition of Group A by the Group, refer to note D.1 of the financial statements.

A. BASIS OF PREPARATION

The consolidated financial statements cover the twelve-month periods ended December 31, 2005 and December 31, 2004.

In accordance with Regulation No. 1606/2002 of the European Parliament and Council of July 19, 2002 on the application of international accounting standards, the Group is presenting its consolidated financial statements in accordance with international financial reporting standards (IFRS) from January 1, 2005 onwards.

The consolidated financial statements of the Group for the year ended December 31, 2005 have been prepared in compliance with IFRS adopted by the European Union as of December 31, 2005 and with IFRS issued by the International Accounting Standards Board (IASB) as of the same date. The term "IFRS" refers collectively to International Accounting Standards (IAS), International Financial Reporting Standards (IFRS), Standing Interpretations Committee (SIC) interpretations and International Financial Reporting Interpretations Committee (IFRIC) interpretations issued by the IASB as of December 31, 2005 and applicable in 2005. The opening balance sheet as of the transition date (January 1, 2004) and the comparative financial statements for the year ended December 31, 2004 have been prepared in accordance with the same principles.

Note F presents the IFRS transition adjustments made by the Group to the consolidated balance sheets as of January 1, 2004 and December 31, 2004 and to the income statement for the year ended December 31, 2004 as initially prepared under Previous GAAP.

The consolidated financial statements have been prepared in accordance with the IFRS general principles of fair presentation, going concern, accrual basis of accounting, consistency of presentation, materiality, and aggregation.

New standards and interpretations issued during 2005 and applied in the consolidated financial statements for the year ended December 31, 2005 are described below. Standards and interpretations that were issued in 2005 but do not apply in 2005 are mentioned in Note B.29.

Amendment to IAS 39 (Financial Instruments: Recognition and Measurement) – Cash Flow Hedge Accounting of Forecast Intragroup Transactions : This amendment is applicable in 2006, but may be applied in 2005. The Group has elected to apply the amendment with effect from the year ended December 31, 2005. However, adoption of the amendment has no effect compared with the method previously applied.

Emission Rights – IFRIC 3 having been withdrawn by the IASB, the Group has applied the guidance in a position statement issued by its local regulator on accounting for greenhouse gas emission allowances. The accounting treatment of emission allowances is described in Note B.13, and the effects on the financial statements are disclosed in Note D.4.

Exemptions and exceptions under IFRS 1

IFRS 1 (First-time Adoption of International Financial Reporting Standards) has been applied in preparing these financial statements. IFRS 1 requires retrospective application of all IFRS that are effective at the reporting date. However, IFRS 1 allows some optional treatments, of which the following have been applied by the Group:

- Business combinations: Business combinations that were consummated prior to the date of transition to IFRS (January 1, 2004) have not been restated in accordance with IFRS 3 (Business Combinations).
- Employee benefits: All previously unrecognized actuarial gains and losses have been recognized in retained earnings at the transition date. The Group will apply the corridor approach of IAS 19 (Employee Benefits) prospectively.
- Cumulative translation differences: All cumulative translation differences for all foreign operations have been eliminated through equity, having been deemed to be zero at the IFRS transition date.
- Designation of previously recognized financial instruments: the Group has classified financial assets either as "available for sale" or as "fair value through profit and loss" from the transition date in accordance with IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement).
- Share-based payment: the Group has applied IFRS 2 (Share-Based Payment) to all equity instruments previously granted and not vested as of January 1, 2004.

In addition, the Group has chosen to apply IAS 32 and IAS 39 from January 1, 2004 onwards.

However, IFRS 1 enforces some mandatory exceptions to retrospective application of IFRS: derecognition of financial assets and financial liabilities, hedge accounting, accounting for changes in estimates, and classification of assets held for sale and discontinued operations. The Group has applied IFRS requirements on these items prospectively.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions, based on information available at the balance sheet date, which may affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements and disclosures of contingent assets and liabilities as of that date. Examples include:

- the amount of provisions for returns, trade receivables, and product claims;
- the length of product life cycles;
- the amount of provisions for restructuring, income tax exposures, environmental liabilities and litigation;
- the valuation of goodwill, and the valuation and estimated useful life of acquired intangible assets;
- fair values of derivative financial instruments.

Actual results could differ from these estimates.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

B.1. Basis of consolidation

The consolidated financial statements include the accounts of Pharma and subsidiaries controlled by Pharma, using the full consolidation method. The existence of effectively exercisable or convertible potential voting rights is taken into account in determining whether control exists.

Joint ventures are accounted for by the equity method in accordance with the option in IAS 31 (Interests in Joint Ventures).

Companies over which the Group exercises significant influence are accounted for by the equity method.

Companies are consolidated from the date on which control (exclusive or joint) or significant influence is transferred to the Group. The Group's share of post-acquisition profits or losses is taken to the income statement, and post-acquisition movements in the acquiree's reserves are taken to consolidated reserves. Companies are excluded from consolidation from the date on which the Group transfers control or significant influence.

B.2. Foreign currency translation

Accounting for transactions in foreign currencies in individual company accounts

Non-current assets and inventories acquired in foreign currencies are translated into the functional currency using the exchange rate prevailing at the date of acquisition.

All amounts receivable or payable in foreign currencies are translated using the exchange rate prevailing at the balance sheet date or, where hedging instruments have been contracted in the market, at the hedged rate. The resulting gains and losses are recorded in the income statement. However, foreign exchange gains and losses arising from the translation of capitalizable advances made to consolidated subsidiaries are recognized directly in equity on the line **Cumulative translation difference**.

Foreign currency translation of the financial statements of foreign subsidiaries

In accordance with IAS 21 (The Effects of Changes in Foreign Exchange Rates), each Group subsidiary translates foreign currency transactions into the currency that is most representative of its economic environment (the functional currency).

All assets and liabilities are translated into euros using the exchange rate of the subsidiary's functional currency prevailing at the balance sheet date. Income statements are translated using a weighted average exchange rate for the period. The resulting translation difference is shown as a separate component of shareholders' equity and is recognized in the income statement only when the subsidiary is sold or is wholly or partially liquidated.

Under the exemptions allowed by IFRS 1, the Group elected to eliminate through equity all cumulative translation differences for subsidiaries with a functional currency other than euro at the January 1, 2004 transition date.

B.3. Business combinations

B.3.1. Accounting treatment

Business combinations consummated subsequent to the IFRS transition date (January 1, 2004) are accounted for by the purchase method in accordance with IFRS 3 (Business Combinations).

Under this method, the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria of IFRS 3 are measured initially at their fair values as at the date of acquisition, except for non-current assets classified as held for sale, which are measured at fair value less costs to sell.

Only identifiable liabilities that satisfy the criteria for recognition as a liability by the acquiree are recognized in a business combination. Consequently, restructuring liabilities are not recognized as a liability of the acquiree unless the acquiree has an obligation as at the date of the acquisition to carry out the restructuring.

Adjustments to the values of assets and liabilities initially determined provisionally (pending the results of independent valuations or further analysis) are recognized as a retrospective adjustment to goodwill if they are made within twelve months of the acquisition date. Once this twelve-month period has elapsed, the effects of any adjustments are recognized directly in the income statement, unless they qualify as an error correction.

Under the exemptions allowed by IFRS 1, the Group elected not to restate in accordance with IFRS 3 any business combinations that were consummated prior to the January 1, 2004 transition date. This includes the Pharma merger that took place in 1999.

B.3.2. Goodwill

The difference between the cost of an acquisition (including any costs directly attributable to the acquisition) and the Group's interest in the fair value of the net assets of the acquiree is recognized as goodwill at the date of the business combination.

Goodwill arising on the acquisition of subsidiaries is shown as a separate intangible asset in the balance sheet under **Goodwill**, whereas goodwill arising on the acquisition of associates is recorded in **Investment in associates**.

Goodwill is measured in the currency of the acquiree.

In accordance with IFRS 3 and with IAS 36 (Impairment of Assets), goodwill is carried at cost less accumulated impairment.

Goodwill is tested for impairment annually and whenever events or circumstances indicate that impairment might exist. Such events or circumstances include significant changes liable to have an other-than-temporary impact on the substance of the original investment.

B.4. Intangible assets

Intangible assets are initially measured at acquisition cost or production cost, including any directly attributable costs of preparing the asset for its intended use, or (in the case of assets acquired in a business combination) at fair value as at the date of the combination. They are amortized on a straight line basis over their useful lives.

The useful lives of intangible assets are reviewed at each balance sheet date. The effect of any adjustment to useful lives is recognized prospectively as a change of accounting estimate.

Amortization of intangible assets is recognized in the income statement under **Amortization of intangibles** with the exception of amortization of acquired or internally-developed software, which is recognized on the relevant line of the income statement according to the purpose for which the software is used.

The Group does not own any intangible assets with an indefinite useful life.

When there is an internal or external indication of impairment, the Group estimates the recoverable amount of the intangible asset and recognizes an impairment loss when the carrying amount of the asset exceeds its recoverable amount. These indications of impairment are reviewed at each reporting date.

Intangible assets are carried at cost less accumulated amortization and impairment, in accordance with IAS 36.

Gains and losses on disposals of intangible assets are measured as the difference between selling price and carrying amount, and are taken to the income statement in **Other operating income and expenses**.

B.4.1. Research and development not acquired in a business combination

- Internally generated research and development

Under IAS 38 (Intangible Assets), an intangible asset is recognized when it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group and when the cost of the asset can be measured reliably. Internally generated research expenditure does not satisfy these criteria, and therefore is expensed as incurred under **Research and development expenses**.

Internally generated development expenses are recognized as an intangible asset if, and only if, all the following can be demonstrated: (a) the technical feasibility of completing the development project; (b) the Group's intention to complete the project; (c) the Group's ability to use the project; (d) the probability that the project will generate future economic benefits; (e) the availability of adequate technical, financial and other resources to complete the project; and (f) the ability to measure the development expenditure reliably. Due to the risks and uncertainties relating to regulatory approval and to the research and development process, the criteria for capitalization are considered not to have been met until marketing approval has been obtained from the regulatory authorities.

On the other hand, chemical industrial development expenses incurred to develop a second-generation process are additional development costs incurred to improve the industrial process for an active ingredient. Such costs are incurred after initial regulatory approval has been obtained and are capitalized under **Intangible assets** as incurred.

- Separately acquired research and development

Separately acquired development is capitalized, because the recognition criteria for intangible assets under IAS 38 are considered to be satisfied in all cases in accordance with paragraph 25 of IAS 38.

Consequently, rights to pharmaceutical products acquired from third parties prior to receipt of regulatory approval to market the products are recognized as intangible assets, and are amortized on a straight line basis over their useful lives from the date on which regulatory approval is obtained.

Payments under research and development arrangements relating to access to technology or to databases, and payments made to purchase generics files, are also capitalized.

Subcontracting arrangements, payments for research and development services and continuous payments under research and development collaborations unrelated to the outcome of the research and development efforts are expensed over the service term.

B.4.2. Other intangible assets

Patents are capitalized at acquisition cost and amortized over the shorter of the period of legal protection or their useful life.

Licenses other than those related to pharmaceutical products and research projects, in particular software licenses, are capitalized at acquisition cost, including any directly attributable cost of preparing the software for its intended use. Software licenses are amortized on a straight line basis over their useful lives (3 to 5 years).

Internally generated costs incurred to develop or upgrade software are capitalized if the IAS 38 criteria for recognition as an intangible asset are satisfied, and amortized on a straight line basis over the useful life of the software from the date on which the software is ready for use.

B.4.3. Intangible assets acquired in a business combination

Intangible assets acquired in a business combination (in particular the acquisition of Group A) which relate to in-process research and development and are reliably measurable are separately identified from goodwill and capitalized in **Intangible assets** in accordance with IFRS 3 (Business Combinations) and IAS 38 (Intangible Assets). The related deferred tax liability is also recognized.

In-process research and development acquired in a business combination is amortized on a straight line basis over its useful life from the date of receipt of regulatory approval for the product derived from the research and development work.

Rights to products sold by the Group, mainly acquired through the acquisition of Group A, are amortized on a straight line basis over their useful lives, which are calculated on the basis of cash flow forecasts that take account of (among other factors) the period of legal protection of the related patents. On this basis, the average amortization period for products sold by the Group is eight years.

B.5. Property, plant and equipment

Property, plant and equipment is initially measured and recognized at acquisition cost, including any directly attributable cost of preparing the asset for its intended use, or (in the case of assets acquired in a business combination) at fair value as at the date of the combination. The component-based approach to accounting for property, plant and equipment is applied. Under this approach, each component of an item of property, plant and equipment with a cost which is significant in relation to the total cost of the item and which has a different useful life from the other components must be depreciated separately. After initial measurement, property, plant and equipment is carried at cost less accumulated depreciation and impairment, except for land which is carried at cost less impairment.

Subsequent costs are not recognized as assets unless (i) it is probable that future economic benefits associated with these costs will flow to the Group and (ii) the costs can be measured reliably.

Day-to-day maintenance costs of property, plant and equipment are expensed as incurred.

Borrowing costs attributable to the financing of items of property, plant and equipment and incurred during the construction period of such items are capitalized as part of the acquisition cost of the item.

Government grants relating to non-current assets are deducted from the acquisition cost of the asset to which they relate.

In accordance with IAS 17 (Leases), items of property, plant and equipment leased by the Group as lessee under finance leases are recognized as an asset in the balance sheet, with the related lease obligation recognized as a liability. A lease qualifies as a finance lease if it transfers substantially all the risks and rewards of ownership of the asset to the Group. Assets held under finance leases are carried at the lower of the fair value of the leased asset or the present value of the minimum lease payments, and are depreciated over the shorter of the useful life of the asset or the term of the lease.

The depreciable amount of items of property, plant and equipment, net of any residual value, is depreciated on a straight line basis over the useful life of the asset. The useful life of an asset is equivalent to its economic life.

The useful lives of property, plant and equipment are as follows:

Buildings	15 to 40 years
Fixtures	10 to 20 years
Plant and equipment	5 to 15 years
Other tangible fixed assets	3 to 15 years

Useful lives and residual values of property, plant and equipment are reviewed at each balance sheet date. The effect of any adjustment to useful lives or residual values is recognized prospectively as a change of accounting estimate.

Depreciation of property, plant and equipment is recognized on the relevant line of the income statement according to the purpose for which the asset is used.

When there is an internal or external indication of impairment, the Group estimates the recoverable amount of items of property, plant and equipment and recognizes an impairment loss when the carrying amount of the item exceeds its recoverable amount. These indications of impairment are reviewed at each reporting date.

Gains and losses on disposals of property, plant and equipment are determined by comparing the disposal price with the carrying amount, and are recognized in the income statement on the line **Other operating income and expenses**.

B.6. Impairment of property, plant and equipment and intangibles

Assets that generate separate cash flows and assets included in cash-generating units (CGUs) are assessed for impairment in accordance with IAS 36 when events or changes in circumstances indicate that the asset or CGU may be impaired.

A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Indications of impairment are reviewed at each reporting date. If there is any internal or external indication of impairment, the Group estimates the recoverable amount of the asset or CGU.

Intangible assets not yet available for use (such as capitalized in-process research and development), and CGUs that include goodwill, are tested for impairment annually whether or not there is any indication of impairment, and as soon as any event or circumstance indicates that they might be impaired. These assets are not amortized.

When there is an internal or external indication of impairment, the Group estimates the recoverable amount of the asset and recognizes an impairment loss when the carrying amount of the asset exceeds its recoverable amount. Where it is not possible to estimate the recoverable amount of any particular asset, the Group determines the recoverable amount of the CGU to which the asset belongs. The recoverable amount of the asset is the higher of its fair value less costs to sell or its value in use. To determine the value in use, the Group uses estimates of future cash flows generated by the asset or CGU, prepared using the same methods as those used in the initial measurement of the asset or CGU on the basis of the medium-term plans of each business activity, generally over a period of four years. Where appropriate, cash flows beyond this period are estimated by applying a flat or

declining growth rate to future periods.

In the case of goodwill, a 20-year cash flow projection period is used. For other intangible assets, the period used is the period of protection provided by the related patent.

Estimated cash flows are discounted at long-term market interest rates that reflect the best estimate by the Group of the time value of money, the risks specific to the asset or CGU, and economic conditions in the geographical regions in which the business activity associated with the asset or CGU is located.

Certain assets and liabilities that are not directly attributable to a specific CGU, and goodwill, are allocated between CGUs on a reasonable and consistent basis.

Goodwill is tested for impairment by being allocated to CGUs. Given the international nature of the Group's activities, the CGUs used for the allocation and impairment testing of goodwill are the same business segments and geographical segments as used for segmental reporting.

Impairment losses and reversals of impairment losses are recognized under **Impairment of property, plant and equipment and intangibles** in the income statement. Impairment losses taken against goodwill are never reversed.

In compliance with IFRS 1, an impairment review was conducted for IFRS transition purposes. This review was performed in accordance with the requirements of IAS 36 (Impairment of Assets). No adjustments were required as a result of this review.

B.7. Assets held for sale

Under IFRS 5 (Non-Current Assets Held for Sale and Discontinued Operations), non-current assets held for sale are defined as assets that will be realized through sale rather than continuing use. Once they have been classified as such, non-current assets held for sale are measured at the lower of carrying amount or fair value less costs to sell net of any impairment losses, and are not depreciated or amortized.

B.8. Financial instruments

B.8.1. Financial assets

Under IFRS, and in accordance with IAS 39 and IAS 32, the Group has adopted the following classification for investments, based on management intent at the date of acquisition (except for investments already held at the transition date and reclassified at that date in accordance with IFRS 1). The designation and classification of investments is carried out at initial recognition and reassessed at each reporting date.

Purchases of investments are recognized on the date when the Group becomes party to the contractual terms of the investment. On initial recognition, financial assets are measured at fair value, plus direct transaction costs in the case of financial assets not classified as "fair value through profit or loss".

Classification, presentation and subsequent measurement of financial assets are as follows:

- Financial assets at fair value through profit or loss

These assets are classified in the balance sheet under **Financial assets – current** and **Cash and cash equivalents**.

Financial assets at fair value through profit or loss comprise financial assets held for trading and financial instruments designated at fair value through profit and loss on initial recognition. This category consists of financial assets acquired principally for the purpose of selling them in the near term (usually within less than 12 months). Derivative instruments are classified as held for trading unless they are designated as hedging instruments.

These financial assets are carried at fair value, without any deduction for transaction costs that may be incurred on sale. Realized and unrealized gains and losses resulting from changes in the fair value of these assets are recognized in the income statement, in **Financial income/Financial expenses**.

Realized and unrealized foreign exchange gains and losses on financial assets in currencies other than the euro are recognized in the income statement in **Financial income/Financial expenses**.

- Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are (i) designated by management as available for sale or (ii) not classified as "financial assets at fair value through profit or loss", "held-to-maturity investments" or "loans and receivables". This category includes participating interests in quoted or unquoted companies (other than investments in associates and joint ventures) that management intends to hold on a long-term basis. Available-for-sale financial assets are classified in non-current assets under **Financial assets – non-current**.

Available-for-sale financial assets are measured at fair value, without any deduction for transaction costs that may be incurred on sale. Gains and losses arising from changes in the fair value of these assets, including unrealized foreign exchange gains and losses, are recognized in equity, under **Items recognized directly in equity**, in the period in which they occur, except for impairment losses and foreign exchange gains and losses on debt instruments. On derecognition of an available-for-sale financial asset, or on recognition of an impairment loss on such an asset, the cumulative gains and losses previously recognized in equity are recognized in the income statement for the period under **Financial income/Financial expenses**.

Interest income and dividends on equity instruments are recognized in the income statement under **Financial income** when the Group is entitled to receive payment.

Available-for-sale financial assets in the form of participating interests in companies not quoted in an active market are measured at cost if their fair value cannot be determined.

Realized foreign exchange gains and losses are recognized in the income statement under **Financial income/Financial expenses**.

- Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intention and ability to hold to maturity.

These investments are measured at amortized cost using the effective interest method.

The Group did not hold any such investments during the year ended December 31, 2004 or during the year ended December 31, 2005.

- Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are presented in current assets (under **Other current assets** in the case of loans and under **Accounts receivable** in the case of receivables) if they have a maturity of less than 12 months at the balance sheet date, and in **Financial assets – non current** if they have a maturity of more than 12 months. Loans and receivables are measured at amortized cost using the effective interest method.

Realized and unrealized foreign exchange gains and losses are recognized in the income statement under **Financial income/Financial expenses**.

B.8.2. Impairment of financial assets

Indicators of impairment are reviewed for all financial assets at each reporting date. Such indicators include default in contractual payments, significant financial difficulties of the issuer or debtor, probability of bankruptcy, or prolonged or significant decline in quoted market price. An impairment loss is recognized in the income statement when there is objective evidence that an asset is impaired.

Impairment losses are measured and recognized as follows:

- The impairment loss on loans and receivables and on held-to-maturity investments, which are measured at amortized cost, is the difference between the carrying amount of the asset and the present value of its estimated future cash flows discounted using the effective interest method.
- When an impairment loss is identified on an available-for-sale financial asset, the cumulative losses previously recognized directly in equity are recorded in the income statement. The impairment loss is the difference between the acquisition cost (net of principal repayments and amortization) and the fair value at the time of impairment, less any impairment losses previously recognized in the income statement.
- The impairment loss on investments in companies that are not quoted in an active market and are measured at cost is the difference between the carrying amount of the investment and the present value of its estimated future cash flows discounted at the current market rate of return for similar financial assets.

Impairment losses on financial assets are recognized under **Financial expenses**.

Impairment losses on investments in companies that are not quoted in an active market and are measured at cost, and on equity instruments classified as available-for-sale financial assets, cannot be reversed through the income statement.

B.8.3. Derivative instruments

Derivative instruments not designated as hedges of operating transactions are initially and subsequently measured at fair value with changes in fair value recognized in the income statement, under **Financial income/Financial expenses**, in the period when they arise.

Derivative instruments qualifying as hedging instruments are measured in accordance with the hedge accounting requirements of IAS 39 (see Note B.8.4.).

B.8.4. Hedging

Hedging involves the use of derivative financial instruments. Changes in the fair value of these instruments are intended to offset the exposure of the hedged item to changes in fair value.

As part of its overall interest rate risk and foreign exchange risk management policy, the Group enters into various transactions involving derivative instruments. Derivative instruments used in connection with the Group's hedging policy may include forward exchange contracts, currency options and interest rate swaps.

Derivative financial instruments qualify as hedging instruments for hedge accounting purposes when (a) at the inception of the hedge there is formal designation and documentation of the hedging relationship and of the risk management strategy and objective; (b) the hedge is expected to be highly effective in offsetting the risk; (c) the forecasted transaction being hedged is highly probable and presents an exposure to variations in cash flows that could ultimately affect profit or loss; (d) the effectiveness of the hedge can be reliably measured; and (e) the hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the reporting periods for which the hedge was designated.

These criteria are applied when the Group uses derivative instruments designated as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation.

- Fair value hedge

A fair value hedge is a hedge of the exposure to changes in fair value of a recognized asset or liability or unrecognized firm commitment that could affect profit or loss.

Changes in fair value of the hedging instrument and changes in fair value of the hedged item attributable to the hedged risk are recognized in the income statement, under **Other current operating income** for hedges of operating activities and under **Financial income/Financial expenses** for hedges of investing or financing activities.

- Cash flow hedge

A cash flow hedge is a hedge of the exposure to variability in cash flows attributable to a particular risk associated with a recognized asset or liability, or a highly probable forecasted transaction that could affect profit or loss.

Changes in fair value of the hedging instrument attributable to the effective portion of the hedge are recognized in equity, under **Items recognized directly in equity**.

Changes in fair value attributable to the ineffective portion of the hedge are recognized in the income statement under **Other current operating income and expenses** for hedges of operating activities, and under **Financial income/Financial expenses** for hedges of investing or financing activities.

Cumulative changes in fair value of the hedging instrument previously recognized in equity are transferred to the income statement when the hedged transaction affects profit or loss. These transferred gains and losses are recorded under **Other current operating income and expenses** for hedges of operating activities and **Financial income/Financial expenses** for hedges of investing or financing activities.

When a forecasted transaction results in the recognition of a non-financial asset or liability, cumulative changes in the fair value of the hedging instrument previously recognized in equity are included in the initial measurement of the asset or liability.

- Hedge of a net investment in a foreign operation

A hedge of a net investment in a foreign operation is accounted for in the same way as a cash flow hedge. Changes in fair value of the hedging instrument attributable to the effective portion of the hedge are recognized in equity, under **Items recognized directly in equity**. Changes in fair value attributable to the ineffective portion of the hedge are recognized in the income statement under **Financial income/Financial expenses**. When the investment in the foreign operation is sold, or wholly or partially liquidated, the changes in the fair value of the hedging instrument previously recognized in equity are transferred to the income statement under **Financial income/Financial expenses**.

Hedge accounting is discontinued when (a) the hedging instrument expires or is sold, terminated or exercised, or (b) the hedge no longer meets the criteria for hedge accounting, or (c) the Group revokes the hedge designation, or (d) management no longer expects the forecasted transaction to occur.

When hedge accounting is discontinued, the cumulative gains or losses previously recognized in equity remain in equity, and are not transferred to the income statement until the forecasted transaction actually occurs. However, when a forecasted transaction is no longer expected to occur, the cumulative gains or losses previously recognized in equity are immediately recognized in the income statement.

B.8.5. Financial liabilities

Financial liabilities are composed of bank borrowings and debt instruments. Bank borrowings and debt instruments are initially measured at fair value of the consideration received, net of directly attributable transaction costs.

Subsequently, they are measured at amortized cost using the effective interest method. All costs related to the issuance of borrowings or debt instruments, and all differences between the issue proceeds net of transaction costs and the value on redemption, are recognized under **Financial expenses** in the income statement over the term of the debt using the effective interest method.

B.8.6. Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value of financial assets and liabilities that are traded in an active market is determined by reference to stock market prices at the reporting date in the case of participating interests and other investments, and by reference to market prices at the reporting date in the case of derivative instruments traded in an active market. The fair value of financial assets or liabilities that are not quoted in an active market is based on various valuation methods and assumptions made by the Group with reference to market conditions prevailing at the reporting date.

B.8.7. Derecognition of financial instruments

The Group derecognizes financial assets when the contractual rights to cash flows from the asset have ended or have been transferred and when the Group has transferred substantially all risks and rewards of ownership. If the Group has neither transferred nor retained substantially all the risks and rewards of ownership, financial assets are derecognized if control is not retained.

Financial liabilities are derecognized when the Group's contractual obligations are discharged or cancelled, or expire.

B.9. Inventories

Inventories are measured at the lower of cost or net realizable value. Cost is calculated using the weighted average cost method or the first-in, first-out method, depending on the nature of the inventory.

The cost of finished goods inventories includes costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

B.10. Cash and cash equivalents

Cash and cash equivalents as shown in the balance sheet and statement of cash flows comprise cash, plus liquid short-term investments that are (i) readily convertible into cash and (ii) subject to an insignificant risk of changes in value in the event of movements in interest rates.

B.11. Treasury shares

In accordance with IAS 32, Group treasury shares are deducted from equity irrespective of the purpose for which they are held. No gain or loss is recognized in the income statement on the purchase, sale, impairment or cancellation of treasury shares.

B.12. Provisions for risks

In accordance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets), the Group records a provision where it has a present obligation, whether legal or constructive, as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the outflow of resources. If the obligation is expected to be settled more than twelve months after the balance sheet date, or has no definite settlement date, the provision is recorded under **Provisions and other non-current liabilities**.

Contingent liabilities are not recognized, but are disclosed in the notes to the financial statements unless the possibility of an outflow of economic resources is remote.

Provisions are estimated on the basis of actual events and circumstances and past experience, and of management's best estimate at the balance sheet date.

Reimbursements offsetting the probable outflow of resources are recognized as assets only if it is virtually certain that they will be received. Contingent assets are not recognized.

Restructuring provisions are recognized if the Group has a detailed, formal restructuring plan and has announced its intention to implement this plan to those affected by it.

No provisions are recorded for future operating losses.

The Group records long-term provisions for certain obligations, such as legal environmental obligations and litigation in which the Group will probably be held liable. Where the effect of the time value of money is material, these provisions are measured at the present value of the expenditures expected to be required to settle the obligation, calculated using a discount rate that reflects an estimate of the time value of money and the risks specific to the obligation.

Increases in provisions to reflect the effects of the passage of time, and gains and losses arising from changes in the discount rate, are recognized in **Financial income/Financial expenses**.

B.13. Emission rights

Following the Kyoto agreements, the European Union committed to reducing greenhouse gas emissions and instituted an emissions allowance trading scheme. In an initial three-year phase starting in 2005, each member State will allocate annual emission allowance caps to operators included in the scheme. Operators are then obliged to deliver a number of emission allowances corresponding to their actual CO₂ emissions. Approximately ten sites in Europe are covered by the scheme. In accounting for emission allowances, the Group applied a position statement issued by its local regulator, the main principles of which are described below.

The annual allowances allocated by government are recognized as intangible assets measured at fair value at the date of initial recognition, with a matching liability recognized to reflect the government grant effectively arising from the fact that allowances are issued free of charge. As and when allowances are consumed, they are transferred to "Deliverable allowances" in order to recognize the liability to government in respect of actual CO₂ emissions. If the allocated allowances are insufficient to cover actual emissions, an expense is recognized in order to reflect the additional allowances deliverable; this expense is measured at the market value of the allowances.

As of December 31, 2005, the Group had a net overall surplus of allowances. Consequently, recognition of emission allowances had no effect on net income for the year ended December 31, 2005. The financial statements therefore include (i) intangible assets representing the allowances issued by government; (ii) a liability to government representing actual CO₂ emissions; and (iii) a government grant representing unused allowances. 2005 allowances are deliverable on April 30, 2006.

B.14. Revenue recognition

Revenue arising from the sale of goods is presented in the income statement under **Net sales**. Net sales comprise revenue from sales of pharmaceutical products, vaccines, and active ingredients, net of sales returns, of customer incentives and discounts, and of certain sales-based payments paid or payable to the healthcare authorities.

Revenue is recognized when all of the following conditions have been met: the risks and rewards of ownership have been transferred to the customer; the Group no longer has effective control over the goods sold; the amount of revenue and costs associated with the transaction can be measured reliably; and it is probable that the economic benefits associated with the transaction will flow to the Group.

The Group offers various types of price reductions on its products. In particular, products sold in the United States of America are covered by various programs (such as Medicare and Medicaid) under which products are sold at a discount. Rebates are granted to healthcare authorities, and under contractual arrangements with certain customers. Some wholesalers are entitled to chargeback incentives based on the selling price to the end customer, under specific contractual arrangements. Cash discounts may also be granted for prompt payment.

The discounts, incentives and rebates described above are recognized in the period in which the underlying sales are recognized, as a reduction of sales revenue. The same applies to sales returns.

These amounts are calculated as follows:

- Provisions for chargeback incentives are estimated on the basis of the relevant subsidiary's standard sales terms and conditions, and in certain cases on the basis of specific contractual arrangements with the customer. They represent management's best estimate of the ultimate amount of chargeback incentives that will eventually be claimed by the customer.
- Provisions for rebates based on attainment of sales targets are estimated and accrued as each of the underlying sales transactions is recognized.

- Provisions for price reductions under Government and State programs, largely in the United States of America, are estimated on the basis of the specific terms of the relevant regulations and/or agreements, and accrued as each of the underlying sales transactions is recognized.
- Provisions for sales returns are calculated on the basis of management's best estimate of the amount of product that will ultimately be returned by customers.

In each case, the provisions are subject to continuous review and adjustment as appropriate based on the most recent information available to management.

The Group believes that it has the ability to measure each of the above provisions reliably, using the following factors in developing its estimates:

- The nature of the underlying product, and the patient profile of the product
- The specific terms and conditions of Governmental regulations and contracts with governmental authorities, wholesalers and other customers
- Historical data relating to similar contracts, in the case of qualitative and quantitative rebates and chargeback incentives
- Past experience and sales growth trends for the same or similar products
- Actual inventory levels in distribution channels, monitored by the Group using internal sales data and externally provided data
- The shelf life of the Group's products
- Market trends including competition, pricing and demand
- The possibility of reusing returned goods

Non-product revenues, mainly comprising royalty income from license arrangements (cf. Note C) that constitute ongoing operations of the Group, are presented in **Other revenues**.

B.15. Cost of sales

Cost of sales consists primarily of the industrial cost of goods sold, payments made under licensing agreements, and distribution costs.

B.16. Research and development expenses

Internally generated research costs are expensed as incurred.

Internally generated pharmaceutical development costs are also expensed as incurred; they are not capitalized, because the criteria for capitalization are considered not to have been met until marketing approval for the related product has been obtained from the regulatory authorities.

Any recharges to or contributions from alliance partners are recorded as a reduction in research and development expenses.

Note B.4.1., **Research and development not acquired in a business combination**, and Note B.4.3., **Intangible assets acquired in a business combination**, describe the principles applied to the recognition of separately acquired research and development.

B.17. Other current operating income

Other current operating income includes the share of profits that the Group is entitled to receive from alliance partners in respect of product marketing agreements (see Note C.2.). It also includes revenues generated under certain complex agreements, which may include partnership and co-promotion agreements.

Upfront payments received are deferred for as long as a service obligation remains. Milestone payments are assessed on a case by case basis, and recognized in the income statement on delivery of the products and/or provision of the services in question. Revenue generated in connection with these services is recognized on the basis of delivery of the goods or provision of the services to the other contracting party.

This line also includes realized and unrealized foreign exchange gains and losses on operating activities (see Note B.8.4).

B.18. Other current operating expenses

Other current operating expenses mainly comprise the share of profits that alliance partners are entitled to receive from the Group under product marketing agreements.

B.19. Amortization of intangibles

This line records amortization expense for all intangible assets other than software.

B.20. Restructuring costs

Restructuring costs include all early retirement benefits, compensation for early termination of contracts, and rationalization costs relating to restructured sites. Asset impairment losses directly attributable to restructuring are also recorded on this line.

B.21. Impairment of property, plant and equipment and intangibles

This line includes all impairment losses on property, plant and equipment and intangibles, including goodwill. It also includes any reversals of impairment losses on property, plant and equipment and intangibles.

B.22. Other operating income and expenses

Other operating income and expenses mainly comprise costs and provisions related to material litigation, and gains and losses on disposals of property, plant and equipment and intangible assets.

B.23. Financial income/expenses

B.23.1. Financial expenses

Financial expenses mainly comprise interest charges on debt financing, negative changes in the fair value of financial instruments (where changes in fair value are taken to the income statement), realized and unrealized foreign exchange losses on financing and investing activities, and impairment losses (net of any reversals) on financial instruments. Any reversals of impairment losses are also recorded on this line.

Financial expenses also include the expense arising from the unwinding of discount on long-term provisions, except provisions for retirement benefits and other long-term employee benefits.

This line does not include commercial discounts, which are deducted from net sales.

B.23.2. Financial income

Financial income includes interest and dividend income, positive changes in the fair value of financial instruments (where changes in fair value are taken to the income statement), realized and unrealized foreign exchange gains on financing and investing activities, and gains or losses on disposals of financial assets.

B.24. Income taxes

Income tax expense includes all current and deferred taxes of consolidated companies.

The Group accounts for deferred taxes in accordance with IAS 12 (Income Taxes) using the methods described below.

Deferred tax assets and liabilities are recognized on taxable temporary differences, deductible temporary differences, and unused tax losses. Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base.

Deferred tax assets and liabilities are calculated using the tax rate expected to apply in the period when a temporary difference is expected to reverse, based on tax rates adopted or effectively enacted at the balance sheet date.

Unused tax losses and unused tax credits are recognized as deferred tax assets to the extent that it is probable that future taxable profits will be available against which they can be utilized.

The Group recognizes a deferred tax liability for temporary differences relating to investments in subsidiaries and associates and to interests in joint ventures except when the Group is able to control the timing of the reversal of the temporary differences. This applies in particular when the Group is able to control dividend policy and it is probable that the temporary differences will not reverse in the foreseeable future.

No deferred tax is recognized on intragroup transfers of investments in subsidiaries or associates.

All net deferred tax asset and liability positions are then aggregated and shown as separate line items on the assets and liabilities sides of the consolidated balance sheet respectively. Deferred tax assets and liabilities can be offset only if (i) the Group has a legally enforceable right to set off current tax assets and current tax liabilities, and (ii) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority.

Deferred taxes are not discounted, except implicitly in the case of deferred taxes on assets and liabilities which are themselves discounted.

Withholding taxes on intragroup royalties and dividends, and on royalties and dividends collected from third parties, are accounted for as current income taxes.

In accounting for business combinations, the Group complies with IFRS 3 as regards the recognition of deferred tax assets after the initial accounting period. This means that if any of the acquiree deferred tax assets are recognized after the end of this period on temporary differences or unused tax losses existing at the date of the combination, a corresponding reduction is made to the amount of goodwill.

B.25. Employee benefit obligations

The Group offers retirement benefits to employees and retirees of the Group. These benefits are accounted for in accordance with IAS 19 (Employee Benefits).

These benefits are in the form of either defined-contribution plans or defined-benefit plans.

In the case of defined-contribution plans, the contributions paid by the Group are expensed in the period in which they occur, and no actuarial estimate is performed.

In the case of defined-benefit plans, the Group recognizes its obligations to employees as a liability, based on an actuarial estimate of the rights vested and/or currently vesting in employees and retirees using the projected unit credit method, net of the estimated fair value of plan assets.

These estimates are performed annually, and rely on assumptions about mortality, employee turnover, and salary increases. The estimated obligation is discounted.

Obligations in respect of other post-employment benefits (healthcare, life insurance) offered by Group companies to employees are also recognized as a liability based on an actuarial estimate of the rights vested or currently vesting in employees and retirees at the balance sheet date.

Actuarial gains and losses, arising from the effects of changes in actuarial assumptions and from experience adjustments, are recognized in the income statement using the corridor method. Under this method, actuarial gains and losses equal to less than 10% of the greater of the amount of the future obligation or the fair value of plan assets are not recognized. Actuarial gains and losses above this 10% threshold are recognized in the income statement over the expected remaining working lives of the employees.

For the transition to IFRS as of January 1, 2004, all actuarial gains and losses of former Pharma companies not recognized as of that date were recognized in equity under the option offered by IFRS 1 (First-Time Adoption of International Financial Reporting Standards). Actuarial gains and losses of former Group A companies were included in the fair value of the employee benefit obligations assumed at the date of acquisition (August 20, 2004).

B.26. Share-based payment

B.26.1. Stock option plans

The Group has granted a number of equity-settled share-based payment plans (stock option plans) to some of its employees.

In accordance with IFRS 2 (Share-Based Payment), services received from employees as consideration for stock options are recognized as an expense in the income statement, with the matching entry recognized in equity. The expense corresponds to the fair value of the stock option plans at the date of grant, and is charged to income on a straight line basis over the vesting period of the plan (the 3-year or 4-year period during which grantees cannot exercise their options).

The fair value of stock option plans is measured at the grant date using the Black & Scholes valuation model, taking into account the expected life and cancellation rate of the options. This initial measurement is not subsequently adjusted except where an adjustment is required to reflect the actual cancellation rate and the effect of this adjustment is material.

The Group has elected to use the IFRS 1 exemption authorizing retrospective application of IFRS 2 to all stock option plans not wholly vested at the transition date provided that the fair value of these stock option plans has been previously disclosed. The benefit cost recognized therefore relates to rights that vested during the reporting period for all plans granted by the Group and the former companies included in the Group A acquisition.

B.26.2. Employee stock ownership plans

The Group may offer its employees the opportunity to subscribe to reserved share issues at a discount to the reference market price. Shares allotted to employees under these plans fall within the scope of IFRS 2 (Share-Based Payment). The discount is treated as an employee benefit, valued at the subscription date and recognized as an expense.

B.27. Earnings per share

Basic earnings per share is calculated using the weighted average number of shares outstanding during the reporting period, adjusted on a time-weighted basis from the acquisition date to reflect the number of shares held by the Group and acquired in the light of market conditions.

Diluted earnings per share is calculated with the Treasury Stock Method using the weighted average number of ordinary shares, calculated on the assumption that (a) all outstanding dilutive options and warrants are exercised and (b) the Group acquires its own shares at quoted market price for an amount equivalent to the cash received as consideration for the exercise of the options or warrants, plus the expense arising on unamortized stock options.

In the event of a stock split or bonus issue of shares, earnings per share for prior periods is adjusted accordingly.

B.28. Segment reporting

In accordance with IAS 14 (Segment Reporting), the Group reports information by business segment and geographical segment.

The primary level of segment reporting used by the Group is the business segment.

A business segment is a distinguishable component of the Group that is engaged in providing a group of related products and services and is subject to different risks and returns from those of other business segments. The Group has two business segments: pharmaceuticals and human vaccines.

The secondary level of segment reporting used by the Group is the geographical segment. A geographical segment is a distinguishable component of the Group that is engaged in providing a group of related products and services within a particular economic environment and is subject to different risks and returns from those of components operating in other economic environments. The Group has three geographical segments: Europe, the United States of America, and Other Countries.

The split between these segments is based on the Group's organizational and management structure, and on indicators used for internal management reporting purposes.

B.29. New IASB standards and interpretations applicable from 2006 onwards

New standards and interpretations issued in 2005 and applied in the consolidated financial statements are described in Note A. The other standards and interpretations issued in 2005 are listed below, with an indication of the mandatory application date and of the Group's position regarding future application.

- The amendment to IAS 1 (Presentation of Financial Statements) on capital disclosures is applicable from 2007 onwards. This amendment requires additional disclosures on capital to be presented in the notes to the financial statements.
- The amendment to IAS 19 (Employee Benefits) has a mandatory application date of January 1, 2006. The principal change contained in this amendment is the introduction of an option for all actuarial gains and losses to be recognized in shareholders' equity. The Group is currently assessing the effect of this option on the financial statements before deciding whether or not to elect this treatment in 2006.

- The limited amendment to IAS 39 (Financial Instruments: Recognition and Measurement) on the fair value option is applicable from January 1, 2006 onwards. The Group has elected not to apply the fair value option in advance of the mandatory application date in its consolidated financial statements.
- The limited amendments to IFRS 4 (Insurance Contracts) and to IAS 39 (Financial Instruments: Recognition and Measurement) relating to financial guarantee contracts are applicable from January 1, 2006 onwards. These amendments will not have a material impact on the consolidated financial statements of the Group.
- IFRS 6 (Exploration for and Evaluation of Mineral Resources), and the corresponding amendments to IFRS 1, are applicable from 2006 onwards. This standard will have no impact on the consolidated financial statements of the Group.
- IFRS 7 (Financial Instruments: Disclosures) is applicable from January 1, 2007 onwards. The Group is currently assessing the impact of this standard on the notes to the financial statements.

The Group has elected not to apply the following interpretations in 2005 in advance of the mandatory application date, which is from 2006 onwards.

- IFRIC 4 (Determining Whether an Arrangement Contains a Lease)
- IFRIC 6 (Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment)

The Group does not expect adoption of these interpretations in 2006 to have a material impact on the financial statements.

C. ALLIANCES

C.1. Alliance agreements with BMS

Two of the Group's leading products were jointly developed with BMS. As inventor of the two molecules, the Group is paid a royalty on all sales generated by these products. This royalty is recorded in **Other revenues**.

As co-developers of the products, the Group and BMS each receive equal development royalties from their two licensees, which have been responsible, since 1997, for marketing the products using their local distribution networks, composed of the affiliates of both groups. These licensees operate in two separate territories: (i) Europe, Africa and Asia, under the operational management of the Group; and (ii) other countries, under the operational management of BMS.

The products are marketed in different ways in different countries.

Co-promotion consists of a pooling of sales resources under a single brand name, and is preferably achieved through contracts or through appropriate tax-transparent legal entities. Each partner records directly its share of taxable income.

Co-marketing consists of separate marketing of the products by each local affiliate using its own name and resources under different brand names for the product.

In certain countries of Eastern Europe, Africa, Asia, Latin America and the Middle East, the products are marketed on an exclusive basis, either by the Group or by BMS.

In the territory managed by the Group, operations are recognized by the Group as follows:

(i) In most countries of Western Europe and Asia, co-promotion is used for both products. The legal entities used are or other tax-transparent entities, which are majority-owned by and under the operational management of the Group. The Group recognizes all the revenue associated with the sale of the drugs, as well as the corresponding expenses. The share of profits reverting to BMS subsidiaries is shown in **Minority interests** in the income statement, with no tax effect (because BMS receives a pre-tax share of profits).

The presentation of **Minority interests** in the consolidated statement of cash flows takes account of the specific terms of the alliance agreement.

(ii) In Germany, Spain and Greece, and in Italy, co-marketing is used for both products, and the Group recognizes revenues and expenses generated by its own operations.

(iii) In Eastern Europe, Africa, Asia and the Middle East, where the products are marketed exclusively by the Group, the Group recognizes revenues and expenses generated by its own operations.

In the territory managed by BMS, operations are recognized by the Group as follows:

(i) Co-promotion is used in the United States of America and Canada through entities that are majority-owned by and under the operational management of BMS. The Group does not recognize revenues; rather, it invoices the entity for its promotion expenses, records its royalty income in **Other revenues**, and records its share of profits (net of tax) in **Share of profit/loss of associates**.

(ii) In Brazil, Mexico, Argentina, Colombia and Australia, co-marketing is used, and the Group recognizes revenues and expenses generated by its own operations.

(iii) In certain other Latin American countries, where the products are marketed exclusively by the Group, the Group recognizes revenues and expenses generated by its own operations.

C.2. Alliance agreements with PGP

A new-generation product indicated for the treatment and prevention of osteoporosis is developed and marketed in collaboration with PGP under an agreement signed in April 1997. This agreement covers the worldwide development and marketing of the product except for Japan.

On October 8, 2004, the Group and PGPP&G announced that they had signed an agreement to maintain the collaboration on the product. A

formal joint commitment was made on research and development and marketing efforts. In addition, PGP may jointly market the product with the Group in some additional territories.

Local marketing arrangements may take various forms:

- Co-promotion, whereby sales resources are pooled but only one of the two partners invoices product sales. Co-promotion is carried out under contractual agreements and is not based on any specific legal entity. PGP sells the product and incurs all the related costs in the following countries: United States of America, Canada, France, Germany, Belgium, the Netherlands and Luxembourg. The Group recognizes its share of revenues under the agreement as a component of **Operating income – current** on the **Other current operating income** line. In the United Kingdom and Ireland, the Group sells the product, and recognizes all the revenues from sales of the product along with the corresponding expenses.
- Co-marketing, which applies only in Italy, whereby each partner sells the product in the country under its own name, and recognizes all revenue and expenses from its own operations in its income statement.
- In all other territories, the Group has exclusive rights to sell the product. The Group recognizes all revenue and expenses from its own operations in its income statement, but in return for these exclusive rights pays PGP a royalty based on actual sales. This royalty is recognized in **Cost of sales**.

C.3. Alliance agreements with OC

The alliance with OC defined by the agreement of June 28, 2000, governed the arrangements for the marketing for a specific product and for the sharing of profits worldwide. The product was launched in America and Europe in 2002.

On January 7, 2004, the Group reached agreement with OC to acquire all OC's rights relating to the product, together with the interests held by OC in the related joint ventures. From January 1, 2004 to August 31, 2004, the Group fully consolidated all territories.

Under these agreements, the Group made payments to OC based primarily on future sales, and took over all ongoing research and development programs.

As regards Europe and the rest of the world (excluding Japan), the acquisition from OC on January 7, 2004 terminated the exclusive marketing license. This agreement did not alter the arrangements for payments to OC.

In connection with its offer for Company A, on September 1, 2004 the Group sold its worldwide rights to the product and the related assets to the a third party. With effect from that date, the Group no longer recognizes transactions relating to these products.

D. DETAILED NOTES TO THE FINANCIAL STATEMENTS

D.1. Business Combination – Acquisition of Group A in 2004

D.1.1. General description

On August 20, 2004, the Group acquired Group A, a global pharmaceutical group. The activities of Group A consisted of the discovery, development, manufacture and marketing of prescription drugs and vaccines to protect and improve health. The main products developed by Group A are used in treatments to combat breast and lung cancer, thrombosis, seasonal allergies, diabetes and hypertension. At the time of the acquisition, Group A was a world leader in vaccines.

As part of the process of creating the new Group, the two former parent companies were merged on December 31, 2004.

The financial statements of the subsidiaries of Group A have been consolidated with those of the Group with effect from August 20, 2004.

A pro forma income statement for the year ended December 31, 2004 is presented for comparative purposes in Note D.1.3.

D.1.2. Description of the transaction

The total purchase price as measured under IFRS 3 (Business Combinations) was €52,908 million.

The purchase price was split as follows:

• Portion of price settled in cash:	€	15,894 million
• Portion of price settled in shares:	€	36,268 million
• Fair value of former Group A stock option plans:	€	746 million

The portion of the price settled in shares corresponds to the issuance of 651,208,974 Group shares at an average value of €55.69 per share, including the shares issued subsequent to the merger of Group A into the Group.

The fair value of the former Group A stock option plans, estimated at €746 million, represents plans vested or exercisable at August 20, 2004.

In accordance with IFRS 3, the fair value of the identifiable assets, liabilities and contingent liabilities was determined provisionally, based on the situation of Group A as of August 20, 2004.

Given the size and complexity of the acquisition, additional information was obtained as part of the process of finalizing the purchase price allocation during the 12-month period allowed under IFRS 3. This resulted in certain aspects of the purchase price allocation being revisited to reflect finalization of the allocation process.

The impact of these revisions on the acquired net assets of Group A is as follows:

(€ million)	Fair value at August 20, 2004 under IFRS (final amounts)	Fair value at August 20, 2004 under IFRS (preliminary amounts recognized at December 31, 2004)
Property, plant and equipment	4,444	4,438
In-process research and development	5,007	5,046
Amortizable intangible assets (average amortization period: 8 years)	31,279	32,469
Investments in associates	2,735	2,668
Other long-term investments	976	1,019
Goodwill	28,775	26,861
Inventories	3,186	3,210
Cash and cash equivalents	1,644	1,644
Provisions for risks	(5,789)	(4,873)
Long-term debt	(3,524)	(3,524)
Deferred taxes, net	(12,663)	(12,786)
Minority interests	(871)	(837)
Other assets and liabilities, net	(3,415)	(3,551)
Net assets acquired	51,784	51,784
Additional purchase price arising from merger	1,124	1,124
Total purchase price of Group A	52,908	52,908

Goodwill on the Group A acquisition amounted to €29,490 million as of December 31, 2004. The difference between goodwill calculated as of August 20, 2004 and December 31, 2004 breaks down as follows:

• Goodwill arising on August 20, 2004	28,775
• Goodwill arising on the December 23, 2004 merger	715
• Total goodwill on Group A acquisition	29,490

Subsequent revisions to goodwill relate primarily to revisions of the preliminary amounts recognized for provisions for environmental, tax and litigation risks and pension obligations (€916 million) based on additional information obtained, updates of preliminary estimates of the value of the acquired rights to certain former Group A products (€1,229 million), and the resulting deferred tax adjustments (see Note F.2.1.10.).

D.1.3. Pro forma information, unaudited

Pro forma financial information is presented, for comparative purposes, as though the public offer and the transactions described below had taken place on January 1, 2004.

This pro forma financial information is not necessarily indicative of the future results of the Group or of the financial condition of the combined entities that would have been achieved had the transactions described in the notes below been consummated on the dates used as the basis for the preparation of the pro forma financial statements.

Pro forma income statement for the year ended December 31, 2004

(€ million)	Pro forma Year ended Dec. 31, 2004 (unaudited)
Net sales	25,199
Other revenues	1,109
Cost of sales	(6,918)
Gross profit	19,390
Operating income – current	3,786
Operating income	3,199
Income tax expense	(298)
Share of profit/loss of associates	459
Net income before minority interests	2,621
Minority interests	305
Net income	2,316

The following adjustments were made in preparing the pro forma income statement for the year ended December 31, 2004:

- Recognition ahead of the actual transaction date of the divestments of subsidiaries and products:

- deconsolidation from the income statement of the operations and products involved, including amortization charged against the associated intangible assets;
 - recognition of the interest income calculated on the basis of the price received on signature of the agreement at an effective annual interest rate of 3.6%;
 - elimination of net gains on the divestments.
- Other adjustments made in calculating pro forma net income:
- elimination of the income statement effect of the workdown of inventories remeasured at fair value at the time of the acquisition;
 - recognition of charges for the amortization of intangible assets and depreciation of property, plant and equipment identified in the Group A purchase price allocation, computed over the useful lives of the assets in question;
 - elimination of historical amortization of actuarial gains and losses following recognition of employee benefits at fair value;
 - recognition of interest expense on the financing of the Group A acquisition, calculated at an effective annual interest rate of 3.6%;
 - translation of foreign-currency items at the average exchange rate for the periods in question;
 - recognition of deferred tax effects on the above adjustments.

For purposes of comparisons with the 2004 pro forma information, the impact in 2005 of the workdown of inventories remeasured at fair value at the time of the acquisition is as follows:

- expense of €394 million at gross profit level;
- reduction of €145 million in income tax expense;
- additional expense of €22 million in "Share of profit/loss of associates";
- gain of €1 million on the "Minority interests" line.

The net impact of the workdown on 2005 net income is an additional charge of €270 million.

D.2. Effect of other changes in the scope of consolidation

Significant changes during 2005

Acquisitions

On December 21, 2004, at an Extraordinary General Meeting of Shareholders, a Group subsidiary registered in Germany approved a resolution initiating the compulsory buyout by the Group of the shares held by the minority shareholders in return for compensation of €56.50 per share. Some minority shareholders filed claims contesting the validity of the resolution, preventing it from being registered with the Frankfurt Commercial Registry and from taking effect on December 31, 2004.

On July 12, 2005, this litigation was settled out of court. Under the terms of the settlement, the cash compensation was raised to €63.80 per share. This cash compensation was increased by a further €1.20 per share for minority shareholders who agreed to waive in advance any increase in the cash compensation obtained through a judicial appraisal proceeding brought by certain former minority shareholders.

As a result, the resolution was registered with the Commercial Registry and the Group became the sole shareholder as of July 12, 2005.

The offer period under the settlement agreement closed on November 18, 2005. Including transaction costs, the total cost of the shares acquired from minority shareholders during 2005 was €667 million.

Divestments

The principal divestments during 2005 were:

- March 31, 2005: divestment of a German subsidiary in which the Group held a 67% interest as of December 31, 2004.
- March 31, 2005: divestment of a Turkish subsidiary previously 100% owned by the Group.

None of these divestments had a material effect on net income.

D.3. Property, plant and equipment

The table below shows a breakdown of property, plant and equipment (including assets held under finance leases) as of December 31, 2005, December 31, 2004 and January 1, 2004:

	Land	Buildings	Plant & equipment	Fixtures, fittings & other	Property, plant and equipment in process	Total
(€ million)						
Gross value at January 1, 2004	50	692	1,334	373	205	2,654
Impact of Group A acquisition	247	1,441	1,813	167	776	4,444
Acquisitions and other increases	5	22	123	42	524	716
Disposals and other decreases	(12)	(79)	(130)	(32)	(24)	(277)
Translation differences	(3)	(46)	(48)	(3)	(20)	(120)
Transfers	—	129	275	24	(452)	(24)
Gross value at December 31, 2004	287	2,159	3,367	571	1,009	7,393
Changes in scope of consolidation	(4)	(52)	(22)	(1)	(1)	(80)
Acquisitions and other increases	3	49	86	62	818	1,018
Disposals and other decreases	(24)	(38)	(76)	(42)	(2)	(182)
Translation differences	10	166	125	41	43	385
Transfers	(10)	269	206	293	(851)	(93)
Gross value at December 31, 2005	262	2,553	3,686	924	1,016	8,441
Accumulated depreciation and impairment at January 1, 2004	—	(183)	(788)	(235)	—	(1,206)
Depreciation expense and impairment losses	—	(101)	(250)	(56)	(3)	(410)
Disposals, reversals of depreciation	—	29	52	23	—	104
Translation differences	—	—	(2)	2	—	—
Transfers	—	(9)	10	10	—	11
Accumulated depreciation and impairment at December 31, 2004	—	(264)	(978)	(256)	(3)	(1,501)
Changes in scope of consolidation	—	—	9	—	—	9
Depreciation expense	—	(188)	(435)	(125)	—	(748)
Impairment losses	—	(16)	(6)	—	—	(22)
Disposals, reversals of depreciation	—	8	53	32	2	95
Translation differences	(3)	(65)	(73)	(26)	—	(167)
Transfers	(24)	18	219	(137)	1	77
Accumulated depreciation and impairment at December 31, 2005	(27)	(507)	(1,211)	(512)	—	(2,257)
Net book value: January 1, 2004	50	509	546	138	205	1,448
Net book value: Dec. 31, 2004	287	1,895	2,389	315	1,006	5,892
Net book value: Dec. 31, 2005	235	2,046	2,475	412	1,016	6,184

Depreciation expense for 2005 was €748 million (2004: €410 million).

Based on the results of a review of the value of property, plant and equipment, conducted as of December 31, 2005 using the method described in Note B.6, an impairment loss of €22 million was recognized in the year to December 31, 2005, of which €16 million was included in "Restructuring costs" (see Note D.27.).

Acquisitions during 2005 related to investment in the pharmaceuticals business, primarily in industrial facilities (€525 million) and plant and installations at research sites (€225 million). Acquisitions in the vaccines business amounted to €178 million.

The table below shows amounts for assets held under finance leases included in property, plant and equipment as of December 31, 2005 and 2004:

(€ million)	December 31, 2005	December 31, 2004
Land	7	7
Buildings	125	83
Other property, plant and equipment	11	—
Total gross value	143	90
Accumulated depreciation and impairment	(93)	(48)
Net book value	50	42

D.4. Intangible assets

The table below shows a breakdown of intangible assets and goodwill as of December 31, 2005, December 31, 2004 and January 1, 2004:

(€ million)	Trademarks, patents, licenses and other rights	Acquired Group A R&D	Rights to marketed Group A products	Software	Total intangible assets	Goodwill
Gross value at January 1, 2004	1,194	—	—	171	1,365	148
Impact of Group A acquisition	200	5,007	30,714	364	36,285	29,490
Acquisitions and other increases	346	—	—	47	393	16
Disposals and other decreases	(348)	—	(387)	(110)	(845)	(14)
Translation differences	(60)	(261)	(1,596)	(13)	(1,930)	(1,276)
Transfers	7	(271)	271	17	24	—
Gross value at December 31, 2004	1,339	4,475	29,002	476	35,292	28,364
Changes in scope of consolidation	—	—	—	1	1	2
Reclassification as assets held for sale	—	(506)	—	—	(506)	—
Acquisitions and other increases	58	—	—	52	110	342
Disposals and other decreases	(3)	—	—	(9)	(12)	(354)
Translation differences	139	310	2,447	47	2,943	1,907
Transfers	12	(852)	852	(13)	(1)	—
Gross value at December 31, 2005	1,545	3,427	32,301	554	37,827	30,261
Accumulated amortization and impairment at January 1, 2004	(337)	—	—	(103)	(440)	(24)
Amortization expense	(142)	—	(1,439)	(77)	(1,658)	—
Impairment losses	—	(71)	—	—	(71)	—
Disposals/reversals of amortization	29	—	—	2	31	—
Reversals of impairment losses	—	—	—	—	—	—
Translation differences	22	—	52	1	75	(2)
Accumulated amortization and impairment at December 31, 2004	(428)	(71)	(1,387)	(177)	(2,063)	(26)
Amortization expense	(134)	—	(3,899)	(145)	(4,178)	—
Impairment losses	—	(112)	(853)	(1)	(966)	—
Disposals/reversals of amortization	—	—	—	2	2	—
Translation differences	(47)	(2)	(308)	(32)	(389)	(1)
Transfers	(7)	—	—	3	(4)	—
Accumulated amortization and impairment at December 31, 2005	(616)	(185)	(6,447)	(350)	(7,598)	(27)
Net book value: January 1, 2004	857	—	—	68	925	124
Net book value: Dec. 31, 2004	911	4,404	27,615	299	33,229	28,338
Net book value: Dec. 31, 2005	929	3,242	25,854	204	30,229	30,234

The effect of including Group A at fair value is described in Note D.1.

Rights to marketed products and goodwill arising on the Group A acquisition were allocated on the basis of the split of the Group's operations into business and geographical segments, and valued in the currency of the relevant geographical segment (mainly euros and US dollars) with assistance from an independent valuer. The average period of amortization for marketed products is 8 years, based on cash flow forecasts which, among other factors, take account of the period of legal protection offered by the related patents.

Acquisitions during 2004 mainly comprised the buyout of the license and rights held by OC, which were subsequently sold to a third party in 2004.

The main disposals during 2004 were associated with the combination between the Group and Group A (see Note D.1.3.). These were the sale to a third party of the world rights for two products and related assets belonging to the Group on September 1, 2004, and the sale of the rights to another product previously held by Group A, to another third party.

In 2005 the amount shown for goodwill on the line "Acquisitions and other increases" mainly comprised the buyout of certain minority shareholders (see Note D.2.). The line "Disposals and other decreases" mainly comprised the recognition of deferred tax assets associated with the acquisition of Group A, in accordance with the principle described in Note B.24.

The main acquisitions of intangible assets (other than software) during 2005 consisted of the second milestone payment made under the collaboration agreement with Company R; acquired generics files; patents; and the recognition of CO₂ allowances received in accordance with the accounting policy described in Note B.13. The amount recognized (€4 million) corresponds to CO₂ allowances allocated by the French government for 2005 (261,000 tons valued at €16.85 per ton). Actual emissions during 2005, representing allowances to be delivered, amounted to 181,000 tons, equivalent to €3 million.

In 2005, some of the research acquired from Group A (€852 million) came into commercial use, and is being amortized from the date of marketing approval. The main products involved are vaccines launched in the United States of America.

Amortization of intangible assets is recognized in the income statement under **Amortization of intangibles** except for amortization of software, which is recognized on the relevant line of the income statement according to the purpose for which the software is used (€32 million cost of sales, €34 million research and development expenses, €71 million selling expenses and €8 million other current operating expenses).

D.5. Impairment of property, plant and equipment and intangibles

Assets that generate separate cash flows, and assets included in cash-generating units (CGUs), are assessed for impairment in accordance with IAS 36 when events or changes in circumstances indicate that the asset or CGU may be impaired.

Intangible assets not yet available for use (such as capitalized in-process research and development) and goodwill are tested for impairment annually whether or not there is any indication of impairment, and whenever events or circumstances indicate that impairment might exist.

Goodwill was allocated to segmental CGUs at December 31, 2005 and December 31, 2004 as follows.

	December 31, 2005			December 31, 2004		
	Pharma- ceuticals	Vaccines	Total	Pharma- ceuticals	Vaccines	Total
(€ million)						
Europe	12,567	—	12,566	12,322	—	12,322
United States of America	12,555	579	13,134	11,103	502	11,605
Other countries	4,353	180	4,533	4,232	179	4,411
Total carrying amount	29,475	759	30,234	27,657	681	28,338

The recoverable amount of segmental CGUs is determined on the basis of value in use, as derived from discounted estimates of the future cash flows from each CGU.

The following assumptions were used in preparing these cash flow estimates:

	Pharmaceuticals	Vaccines
Operating margin	32% - 41%	29% - 37%
Perpetual growth rate	1.8% - 3.6%	3% - 5%
Discount rate	10%	11%

Some of the assumptions were determined with the assistance of an independent valuer in connection with the Group A acquisition.

- The operating margin used is the weighted average of the operating margins for each business segment. A 20-year cash flow projection period is used.
- The perpetual growth rate is an average rate by business segment and geographical area.
- The discount rate is the average for all geographical areas within a single business segment.

No impairment losses have been recognized against goodwill.

Certain intangible assets for which indicators of potential impairment had been identified during 2005 were tested for impairment.

The results of these tests have led the Group to recognize pre-tax impairment losses of €966 million, primarily in respect of products subject to competition from generics in the United States of America. This amount also includes impairment losses taken against research and development projects recognized at the time of the Group A acquisition (€112 million).

In addition, an after-tax impairment loss of €55 million relating to one specific vaccine was recognized in the books of one of the Group's joint ventures, and included in the Group consolidated financial statements under **Share of profits/losses of associates**.

Impairment losses taken against property, plant and equipment are disclosed in Note D.3.

D.6. Investments in associates, including advances

Associates consist of companies over which the Group exercises significant influence, and joint ventures. The Group accounts for joint ventures using the equity method (i.e. as associates), in accordance with the allowed alternative treatment specified in IAS 31 (Financial Reporting of Interests in Joint Ventures).

Investments in associates (including advances) at December 31, 2005 and December 31, 2004 were as follows:

(€ million)	% interest at December 31, 2005	December 31, 2005	December 31, 2004
Joint Venture A	50.0	551	608
Joint Venture B	50.0	1,451	1,295
Associate A	—	—	400
Associate B	30.0	93	95
Joint Venture C (1)	50.0	—	151
Entities and companies managed by BMS (2)	49.9	195	160
Associate C	39.1	80	126
Other investments and advances	—	107	96
Total		2,477	2,931

(1) See Notes D.8. and D.36. This investment was reclassified to "Assets held for sale" in the balance sheet as of December 31, 2005.

(2) Under the terms of the agreements with BMS (see Note C.1.), entities majority-owned by BMS are accounted for as associates in the balance sheet, with the Group's share of their net assets recorded in **Investments in associates**.

The financial statements include various commercial transactions between the Group and non-consolidated related companies accounted for by the equity method. These transactions are principally purchases and sales.

(€ million)	December 31, 2005
Sales	907
Accounts receivable	319
Purchases	240
Trade payables	42
Other liabilities (1)	318

(1) See Note D.19.

Key financial indicators for these companies as of December 31, 2005 and for the year then ended (excluding the effects of the Group A purchase price allocation, see Note D.1.2.) are shown in the table below:

(€ million)	Principal associates (1) (100% impact)		Principal Joint ventures (share held by the Group)	
	December 31 2005	December 31 2004	December 31 2005	December 31 2004
Non-current assets	1,004	870	291	237
Current assets	2,510	2,674	667	510
Non-current liabilities	467	399	69	60
Current liabilities	1,625	1,964	349	278
Shareholders' equity	1,190	961	538	409
Minority interests	232	220	2	0
Net sales	7,458	6,850	1,136	1,067
Cost of sales	1,949	1,979	289	381
Operating income	1,970	1,860	288	298
Net income	1,714	1,494	184	148

⁽¹⁾ Financial information presented before appropriation of the profits of alliance partners.

D.7. Financial assets – non-current

The main items included in *Financial assets – non-current* are:

<i>(€ million)</i>	December 31, 2005	December 31, 2004
Available-for-sale financial assets	736	469
Prepaid pension obligations (see D18.1.)	3	2
Long-term loans and advances	457	441
Derivative instruments (see D.20.)	122	58
Total carrying amount	1,318	970

The unrealized gain (net of tax) on available-for-sale financial assets recognized directly in equity in the year ended December 31, 2005 amounted to €98 million, compared with €85 million in the year ended December 31, 2004 (see Note D.15.7.).

Available-for-sale financial assets include equity investments in companies not quoted in an active market. The carrying amount of these investments was €66 million at December 31, 2005, compared with €65 million at December 31, 2004.

D.8. Assets held for sale

On January 13, 2006, the Group announced the signature of an agreement to transfer its rights to an inhaled human insulin product to a third party. The terms of the 1998 alliance between Group A and the third party to jointly develop, manufacture and market this product included a change of control clause, which the third party decided to activate following the acquisition of Group A.

Under the terms of the agreement signed on January 13, 2006, the Group will sell to the third party its share in the worldwide rights for the development, manufacture and marketing of the product, along with its interest in the joint venture which owns the insulin manufacturing facility used in the production of the product.

In return for the transfer of these assets and rights, the Group will receive a payment of \$1.3 billion net of local taxes. Completion of the deal is subject to various conditions, one of which – approval by the local antitrust authorities – was fulfilled in January 2006. The sale is expected to be completed during the first quarter of 2006.

The table below shows a breakdown of the assets and liabilities classified as held for sale in connection with the sale of the Group' rights to the product:

<i>(€ million)</i>	
Total assets held for sale	676
Total liabilities related to assets held for sale	(259)
Net value of assets held for sale	417
Acquired in-process research and development (1)	506
Equity-accounted interest in joint venture	139
Liabilities owed to related parties	(46)
Deferred tax liabilities	(172)
Other items	(10)
Total	417

(1) Identified in the Group A purchase price allocation effective August 20, 2004.

D.9. Inventories

Inventories as of December 31, 2005 and December 31, 2004 comprised:

<i>(€ million)</i>	December 31, 2005			December 31, 2004		
	Gross	Impairment	Net	Gross	Impairment	Net
Raw materials	775	(40)	735	645	—	645
Work in process	1,97	(78)	1,892	1,758	—	1,758
Finished goods	963	(160)	803	699	(70)	629
Total	3,70	(278)	3,430	3,102	(70)	3,032

Inventories held by Group A were recognized on the acquisition date at fair value, which differed from production cost (see note D.1.2 on the acquisition of Group A). At December 31, 2005, the residual valuation difference was €34 million, all of which related to inventories of vaccines. At December 31, 2004, the valuation difference was €409 million.

The impact of changes in inventory impairment provisions in the year ended December 31, 2005 was a net expense of €192 million (against €51 million in 2004).

D.10. Accounts receivable

Accounts receivable as at December 31, 2005 and 2004 break down as follows:

<i>(€ million)</i>	December 31, 2005	December 31, 2004
Gross value	5,188	4,532
Impairment	(167)	(78)
Net value	5,021	4,454

Some former Group A companies regularly transferred trade receivables under programs set up in Europe and Japan. All European programs ended in the first quarter of 2005, and all Japanese programs ended in the third quarter of 2005. Proceeds from sales of receivables transferred under these programs amounted to €479 million at December 31, 2004.

D.11. Other current assets

Other current assets as at December 31, 2005 and 2004 break down as follows:

<i>(€ million)</i>	December 31, 2005	December 31, 2004
Taxes recoverable	1,082	1,084
Other receivables (1)	1,151	637
Prepaid expenses	201	268
Total (net)	2,434	1,989

(1) This line mainly comprises amounts due from alliance partners, advance payments to suppliers, sales commission receivable, and amounts due from employees.

D.12. Financial assets – current

Financial assets – current as at December 31, 2005 and 2004 break down as follows:

<i>(€ million)</i>	December 31, 2005	December 31, 2004
Interest rate derivatives measured at fair value (note D.20.)	31	34
Currency derivatives measured at fair value (note D.20.)	257	540
Other current financial assets	23	74
Total (net)	311	648

D.13. Cash and cash equivalents

<i>(€ million)</i>	December 31, 2005	December 31, 2004
Cash (1)	941	1,533
Cash equivalents	308	307
Cash and cash equivalents	1,249	1,840

(1) Includes cash held by captive insurance and reinsurance companies (€447 million at December 31, 2005; €374 million at December 31, 2004).

D.14. Net deferred tax position

The net deferred tax position at December 31, 2005 and 2004 was as follows:

(€ million)	December 31, 2005	December 31, 2004
Deferred tax on:		
• Consolidation adjustments (intragroup margin on inventory)	759	572
• Provision for pensions and other employee benefits	1,039	1,015
• Remeasurement of Group A intangible assets	(10,797)	(12,491)
• Adjustment to fair value of acquired Group A inventories	(13)	(149)
• Recognition of Group A property, plant and equipment at fair value	(111)	(118)
• Adjustment to fair value of debt on acquisition of Group A	36	68
• Tax cost of distributions made from reserves	(794)	(867)
• Stock options	149	—
• Other non-deductible provisions and other items	619	931
Net deferred tax liability	(9,113)	(11,039)

The impact of the first-time consolidation of Group A at fair value on August 20, 2004 was an additional deferred tax liability of €12,663 million (see Note D.1.2.), mainly due to deferred tax liabilities arising on the remeasurement of intangible assets. Deferred tax effects resulting in a matching adjustment to goodwill in 2005 totaled €354 million (see Note D.4.).

Deferred tax recognized directly in equity during 2005 comprised the tax effects of:

- the exercise of stock options held by employees of our U.S. subsidiaries (€60 million);
- the recognition at fair value of available-for-sale financial assets and hedging derivatives (€21 million, see Note D.15.7.).

Deferred tax assets not recognized because their future recovery was regarded as uncertain given the likely future results of the entities in question amounted to €578 million as of December 31, 2005, compared with €415 million as of December 31, 2004.

At December 31, 2005, the Group had €741 million of tax losses available for carry-forward, due to expire as follows:

(€ million)	Tax loss
2006	4
2007	23
2008	34
2009	19
2010	19
2011 and later	642
Total	741

Use of these tax loss carryforwards is limited to the entity in which they arose. In jurisdictions where tax consolidations are applied, carryforwards are able to be netted against taxable income generated by the entities in the consolidated tax group.

In certain countries, withholding taxes and other tax costs are incurred by the Group when dividends are distributed. A €794 million deferred tax liability was recorded at December 31, 2005 in respect of distributions made by some subsidiaries out of their reserves (€867 million at December 31, 2004). The amount of unrecognized deferred tax liabilities on withholding taxes and other taxes on the undistributed profits of some subsidiaries is immaterial, leaving aside the fact these amounts will be reinvested indefinitely.

The net deferred tax position at December 31, 2005 breaks down as follows:

(€ million)	December 31, 2005
Deferred tax assets:	
• Short-term	1,488
• Long-term	1,912
Deferred tax liabilities:	
• Short-term	(136)
• Long-term (1)	(12,377)
Net deferred tax position (liability)	(9,113)

(1) Includes portion reversing within less than one year relating to depreciation and amortization charges on the fair value adjustments to the property, plant and equipment and intangible assets of Group A, estimated at €1,400 million.

D.15. Shareholders' equity

D.15.1. Share capital

The share capital of €2,802,613,138 consists of 1,401,306,569 shares with a par value of €2.

Treasury shares held by the Group are as follows:

Date	Number of shares	%
December 31, 2005	58,211,254	4.1%
December 31, 2004	77,207,485	5.4%
January 1, 2004	49,990,262	6.8%

Treasury shares are deducted from shareholders' equity. Gains and losses on disposals of treasury shares are taken directly to shareholders' equity and are not recognized in net income for the period.

D.15.2. Capital increase reserved for employees (employee share ownership plan)

At its meeting of November 7, 2005, the Board of Directors used the authorization granted by the Combined General Meeting of May 31, 2005 to launch an employee share ownership plan by carrying out a capital increase reserved for employees. The plan involved the issuance of a maximum of 7 million shares, ranking for dividend from January 1, 2005 and priced at €54.09 per share. The subscription period was from November 21, 2005 through December 2, 2005, and a total of 2,037,887 shares were subscribed. An expense of €31 million was recognized, in respect of this capital increase in the income statement, for the year ended December 31, 2005.

D.15.3. Repurchase of Group shares

The General Meeting of Group shareholders of May 31, 2005 authorized a share repurchase program for a period of 18 months.

In the year ended December 31, 2005, the Group did not repurchase any of its own shares under the programs authorized by the General Meetings of June 23, 2004 and May 31, 2005.

D.15.4. Reduction in share capital

The Board of Directors' meeting of May 31, 2005, decided to cancel 16,234,385 treasury shares representing 1.15% of the share capital.

D.15.5. Cumulative translation differences

Cumulative translation differences at December 31, 2005 and December 31, 2004 break down as follows:

(€ million)	December 31, 2005	December 31, 2004
Attributable to Group shareholders	1,332	(2,925)
Attributable to minority interests	2	(35)
Total	1,334	(2,960)

On first-time adoption of IFRS on January 1, 2004, all cumulative translation differences for all foreign operations of the Group were eliminated through shareholders' equity, having been deemed to be zero at the IFRS transition date. Cumulative translation differences previously recorded in the Group A balance sheet were eliminated as of the acquisition date.

The movement in cumulative translation differences during the period was primarily due to the effect of changes in the US dollar exchange rate on intangible assets, goodwill and deferred taxes.

The reduction in minority interests in cumulative translation differences was mainly due to the buyout of certain minority shareholders of a subsidiary, which held equity interests in companies outside the euro zone, especially in the United States of America.

Cumulative translation differences attributable to the Group shareholders at December 31, 2005 include €98 million for the post-tax effect of currency hedges of net investments in foreign operations, in accordance with the accounting policy described in Note B.8.4.

D.15.6. Items recognized directly in equity

Movements in items recognized directly in equity in the years ended December 31, 2005 and 2004 were as follows:

(€ million)	December 31 2005	December 31 2004
Balance, beginning of period	139	70
Available-for-sale financial assets:		
• Gains/(losses) on fair value remeasurement	23	94
• Deferred taxes on these gains/(losses)	(10)	(19)
Derivatives designated as hedging instruments:		
• Gains/(losses) on fair value remeasurement	(89)	(10)
• Deferred taxes on these gains/(losses)	31	4
Balance, end of period	94	139

D.15.7. Share-based payment

Stock option plans and share warrants

a) Assumption by the Group of the obligations of Group A

Stock subscription option plans

With effect from December 31, 2004, the Group has substituted for Group A in all the rights and obligations of the issuer in respect of stock subscription options granted to employees and former corporate officers of Group A and of related companies (as defined in article L.225-180 of the Commercial Code) and not exercised as of that date.

With effect from December 31, 2004, stock subscription options granted by Group A and not yet exercised may be exercised in Group shares on the same terms, subject to the adjustments described below. The number and subscription price of the optioned shares have been adjusted to reflect the share exchange ratio applicable to Group A shareholders, subject to possible further adjustment in the event of future capital transactions. The new terms for the exercise of options, subject to future financial adjustments, are as follows:

- The number of Group shares for which each grantee may subscribe under a given stock option plan equals the number of Group A shares to which the grantee may subscribe under that plan multiplied by the exchange ratio applicable to the shareholders (i.e. 27/23), rounded down to the nearest whole number.
- The subscription price per Group share equals the subscription price per Group A share divided by the exchange ratio applicable to the shareholders (i.e. 27/23), rounded down to the nearest euro cent.

Stock purchase option plans

In the case of stock option plans issued by Group A entitling the grantees to purchase Group A shares, the plan regulations have been amended in accordance with the principles described above so as to enable the grantees to purchase Group shares. The other terms of exercise are unchanged.

Share warrants

Under two capital increases reserved for employees belonging to the Group A employee savings plan, carried out in September 2002 ("Plan Horizon 2002") and December 2003 ("Plan Horizon 2003"), Group A issued, to certain employees, shares accompanied by warrants giving entitlement to subscribe for Group A shares. These shares with warrants attached were subscribed for on behalf of these employees by two dedicated mutual funds.

The Group owns the share warrants issued in 2002 and 2003, having acquired them as part of the public offer for Group A. These warrants are recorded as a deduction from shareholders' equity, amounting to €6 million, on the line **Treasury shares**.

The number of Group shares to which the Group can claim entitlement has been computed by applying the exchange ratio of 27 Group shares for 23 Group A shares. The share warrants issued in 2002 give entitlement to subscribe for a maximum of 108,812 Group shares, and the share warrants issued in 2003 give entitlement to subscribe for a maximum of 193,174 Group shares.

b) Description of stock option plans

New 2005 stock subscription option plan granted by the Group

On May 31, 2005, the Board of Directors granted 15,228,505 stock subscription options at an exercise price of €70.38 per share.

The vesting period is 4 years and the plan expires on May 31, 2015.

Stock purchase option plans

Over time the Group has awarded several stock option plans which allow grantees to purchase a fixed number of shares at a pre-determined price over a specified period. Options generally vest over two to five years from the date of grant and expire seven to twenty years from the date of grant. Shares acquired under these plans generally may not be disposed of prior to the fifth anniversary of the date of grant.

Grantees of Group A options had their options converted into options to purchase Groups shares on completion of the merger on December 31, 2004.

Details of the terms of exercise of stock purchase options granted under the various plans are presented below in Group share equivalents. The table shows all Group stock purchase option plans still outstanding or under which options were exercised in the year ended December 31, 2005.

Date of grant	Options granted	Start date of exercise period	Expiration date	Exercise price (in euros) (*)	Options outstanding at December 31, 2005
12/15/1993	364,000	12/15/1998	12/15/2013	6.36	8,950
10/18/1994	330,200	10/18/1999	10/18/2014	6.01	22,300
02/27/1995	1,032,398	02/28/1998	02/27/2005	12.04	—
11/27/1995	14,863	11/27/1998	11/27/2005	14.03	—
12/15/1995	442,000	12/15/2000	12/15/2015	8.50	5,300
01/12/1996	208,000	01/12/2001	01/12/2016	8.56	32,570
02/27/1996	977,453	02/28/1999	02/27/2006	19.26	103,379
03/01/1996	28,174	03/01/1999	03/01/2006	19.22	—
04/05/1996	228,800	04/05/2001	04/05/2016	10.85	54,500
02/20/1997	1,024,346	02/21/1999	02/20/2007	22.15	157,869
10/14/1997	262,080	10/14/2002	10/14/2017	19.73	63,052
06/25/1998	296,400	06/26/2003	06/25/2018	28.38	90,650
12/10/1998	1,200,000	12/11/2000	12/10/2005	34.95	—
03/30/1999	716,040	03/31/2004	03/30/2019	38.08	481,600
09/07/1999	2,930,799	09/08/2002	09/07/2009	41.25	497,776
05/24/2000	4,292,000	05/25/2004	05/24/2010	43.25	2,791,607

05/10/2001	2,936,500	05/11/2005	05/10/2011	64.50	2,765,515
05/22/2002	3,111,850	05/23/2006	05/22/2012	69.94	3,031,050

10,106,118

Under IFRS, Group shares acquired to cover stock purchase options are deducted from shareholders' equity. The exercise of all outstanding stock purchase options would increase shareholders' equity by €560 million.

Stock subscription option plans

Details of the terms of exercise of stock subscription options granted under the various plans are presented below in the Group share equivalents. These options have been granted to certain corporate officers and employees of Group companies.

The table shows all Group stock subscription option plans which are still outstanding or for which exercise took place in the year ended December 31, 2005.

Date of grant	Options granted	Start date of exercise period	Expiration date	Exercise price (in euros)	Options outstanding at December 31, 2005
02/07/1995	1,350,000	02/07/1998	02/07/2005	15.04	—
12/14/1995	1,760,870	12/14/1998	12/14/2005	13.11	—
12/17/1996	2,054,348	01/06/2000	12/17/2006	20.04	147,527
12/16/1997	4,193,217	01/06/2001	12/16/2007	32.15	680,660
12/15/1998	6,372,000	01/06/2002	12/15/2008	34.14	1,754,587
12/15/1999	5,910,658	01/06/2003	12/15/2009	50.04	3,526,356
05/11/2000	877,766	05/11/2003	05/11/2010	49.65	370,399
11/14/2000	13,966,871	11/15/2003	11/14/2010	67.93	11,418,029
03/29/2001	612,196	03/30/2004	03/29/2011	68.94	557,331
11/07/2001	13,374,051	11/08/2004	11/07/2011	71.39	10,985,337
03/06/2002	1,173,913	03/07/2005	03/06/2012	69.82	1,173,906
11/12/2002	11,775,414	11/13/2005	11/12/2012	51.34	8,747,979
12/02/2003	12,012,414	12/03/2006	12/02/2013	40.48	10,772,382
12/10/2003	4,217,700	12/11/2007	12/10/2013	55.74	4,154,000
05/31/2005	15,228,505	06/01/2009	05/31/2015	70.38	14,936,090
					69,224,583

The exercise of all outstanding stock subscription options would increase shareholders' equity by approximately €4,128 million.

Summary of stock option plans

A summary of stock options outstanding at December 31, 2005, December 31, 2004, and December 31, 2003, and of changes during the relevant periods, is presented below:

	Number of options	Exercise price	
		Weighted average per share (€)	Aggregate (€million)
Options outstanding at December 31, 2003	17,401,648	52.10	907
Group A options converted into Group options	57,349,697	55.69	3,193
Options exercised	(1,391,147)	29.30	(41)
Options expired/forfeited	(105,700)	51.70	(5)
Options outstanding at December 31, 2004	73,254,498	55.34	4,054
<i>of which exercisable</i>	36,471,794	57.25	2,088
Options granted	15,228,505	70.38	1,071
Options exercised	(6,827,577)	44.98	(306)
Options expired/forfeited	(2,324,725)	56.69	(131)
Options outstanding at December 31, 2005	79,330,701	59.10	4,688
<i>of which exercisable</i>	43,860,426	59.60	2,614

The table below provides summary information about options outstanding and exercisable at December 31, 2005:

Range of exercise prices per share	Outstanding			Exercisable	
	Number of options	Average residual life (in years)	Weighted average exercise price per share (€)	Number of options	Weighted average exercise price per share (€)
From €1.00 to €10.00 per share	69,120	9.49	7.45	69,120	7.45
From €10.00 to €20.00 per share	220,931	6.06	17.32	220,931	17.32
From €20.00 to €30.00 per share	396,046	3.72	22.79	396,046	22.79
From €30.00 to €40.00 per share	2,916,847	4.49	34.33	2,916,847	34.33
From €40.00 to €50.00 per share	14,432,164	7.10	41.28	3,659,782	43.63
From €50.00 to €60.00 per share	16,428,335	6.61	52.17	10,284,535	50.89
From €60.00 to €70.00 per share	18,945,831	5.35	67.90	15,327,828	67.42
From €70.00 to €80.00 per share	25,921,427	8.02	70.81	10,985,337	71.39
Total	79,330,701			43,860,426	

Measurement of stock option plans

Plans awarded since 2000 have been measured and recognized as an expense in accordance with IFRS 2 (Share-Based Payment).

Plans awarded prior to 2000 (the vesting period of which ended prior to January 1, 2004) have not been recognized in the consolidated financial statements. The value of all stock subscription option plans awarded by Group A was measured as part of the purchase price allocation (see Note D.1.2), but an accounting expense has been recognized only for plans of which the vesting period was still open at August 20, 2004.

The fair value of the plan awarded in 2005 is €247 million. The fair value of the Group A plans assumed on August 20, 2004 is €1,048 million, of which €746 million was allocated to the purchase price.

The following assumptions were used in determining the fair value of these plans:

- dividend payout of 1.85% (2005 plan) and 2.00% (former Group A plans);
- residual life of 8 years (2005 plan) and of between 0.4 and 8.55 years (former Group A plans);
- volatility of Group shares, computed on a historical basis, of 18.44% (2005 plan);
- volatility of former Group A shares, computed on a historical basis, of 35.3% (former Group A plans);
- risk-free interest rate of 3.08% (2005 plan) and of between 1.98% and 4.13% (former Group A plans).

The weighted average fair value of the options awarded in 2005 is €16.68 per option, and the weighted average fair value of the former Group A options (measured as of August 20, 2004) is €20.81 per option.

The expense recognized for stock option plans, and the matching entry taken to shareholders' equity, amounted to €199 million in the year ended December 31, 2005 and €112 million in the year ended December 31, 2004.

D.15.8. Number of shares used to compute diluted earnings per share

Diluted earnings per share is computed using the number of shares outstanding plus stock options with a potentially dilutive effect.

	2005	2004
Average number of shares outstanding (million)	1,336.5	910.3
Adjustment for options with potentially dilutive effect (million)	10.0	4.5
Average number of shares used to compute diluted earnings per share (million)	1,346.5	914.8

In 2005, a total of 42.1 million stock options were not taken into account in the calculation because they do not have a potentially dilutive effect, compared with 38.2 million in 2004.

D.16. Minority interests

Under the terms of the agreements with BMS (see Note C.1.), the BMS share of the net assets of entities majority-owned by the Group is recognized in **Minority interests**.

D.17. Debt, cash and cash equivalents

The table below shows the Group's net debt at December 31, 2005 and December 31, 2004:

	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Long-term debt, at amortized cost	4,750	8,654
Short-term debt and current portion of long-term debt	6,425	7,388
Cash and cash equivalents	(1,249)	(1,840)
Net debt	9,926	14,202

Reconciliation of carrying amount to value on redemption

	<u>Carrying amount at Dec. 31, 2005</u>	<u>Amortized cost</u>	<u>Adjustment to debt measured at fair value</u>	<u>Value on redemption: Dec. 31, 2005</u>	<u>Value on redemption: Dec. 31, 2004</u>
Long-term debt	4,750	40	(126)	4,664	8,504
Short-term debt and current portion of long-term debt	6,425	15	(12)	6,428	7,388
Cash and cash equivalents	(1,249)	—	—	(1,249)	(1,840)
Net debt	9,926	55	(138)	9,843	14,052

a) Principal financing transactions during the year

During 2005, the €16 billion credit facility used to finance the Group A acquisition, of which €10.5 billion was drawn down at December 31, 2004, was repaid in full. The Group also terminated, in advance of the contractual expiry date; all the confirmed bilateral bank facilities contracted by Group A prior to the acquisition. Five new transactions were used to refinance this debt:

- Syndicated 364-day bank facility of €5 billion with four 364-day extension options and a one-year term out option. The first extension option has been exercised, thereby extending the initial expiry of the facility from January 2006 to January 2007.
- Three bilateral 364-day bank facilities totaling \$1.6 billion (€1.3 billion).

These €6.3 billion bank facilities, which are confirmed but have not been drawn down, are being used to back two commercial paper programs, of €6 billion in France and \$3 billion in the United States of America. In 2005, the average drawdown under these programs was €5 billion (minimum €1.2 billion, maximum €6.3 billion). As of December 31, 2005, drawdowns under these programs amounted to €4.3 billion (1).

- Syndicated bank facility of €8 billion, comprising a 5-year tranche of €5.5 billion (with two one-year extension options exercisable at the end of years 1 and 2) and a 7-year tranche of €2.5 billion. As of December 31, 2005, a total of €1 billion was drawn down under this facility (2).
- Four bank loans of €500 million each maturing March 2008. In December 2005, given the success of the debt reduction program, €1 billion was repaid ahead of the contractual maturity date (3).
- A €1 billion floater bond issue with a 2-year maturity (May 2007) (4).

The financing in place at December 31, 2005 contains no financial covenants, and no clauses indexing credit spreads or fees to the Group credit rating.

b) Net debt by type, at value on redemption

	December 31, 2005			December 31, 2004		
	non-current	current	Total	non-current	current	Total
Bond issues	2,564	1,302	3,866	2,815	—	2,815
Credit facility drawdowns	1,000	—	1,000	—	—	—
Other bank borrowings	1,051	390	1,441	5,636	5,577	11,213
Commercial paper	—	4,353	4,353	—	1,211	1,211
Finance leases	33	5	38	37	—	37
Other borrowings	16	—	16	16	—	16
Bank overdrafts	—	378	378	—	600	600
Total debt	4,664	6,428	11,09	8,504	7,388	15,892
Cash and cash equivalents	—	(1,249)	(1,249)	—	(1,840)	(1,840)
Net debt	4,664	5,179	9,843	8,504	5,548	14,052

The bond issues carried out under Euro Medium Term Note (EMTN) documentation, comprise:

- Bonds issued in April 2001 for a nominal value of €1,250 million, maturing April 18, 2006, bearing annual interest of 5.0%
- Bonds issued in September 2003 for a nominal value of €1,500 million, maturing September 15, 2010, bearing annual interest of 4.25%
- Bonds issued in November 2003 for a nominal value of 100 million Swiss francs, maturing November 12, 2007, bearing annual interest of 1.98%
- Bonds issued in May 2005 for a nominal value of €1,000 million, maturing May 2007, bearing annual interest at 3-month Euribor plus 0.05%
- Bonds issued in June 2005 for a nominal value of 80 million Swiss francs, maturing December 21, 2006, bearing annual interest at 1-month Swiss-franc Libor less 0.01%

The drawdowns under credit facilities and commercial paper programs listed above relate to the facilities and programs described in item **a)** above.

“Other bank borrowings” comprise the €1 billion loan contracted by the parent company as described in item **a)** above, and various loans contracted by subsidiaries.

“Other borrowings” include:

- Participating shares issued between 1983 and 1987, of which 146,678 remain outstanding, valued at €16 million (net of shares held by the Group)
- Series A participating shares issued in 1989, of which 3,296 remain outstanding, valued at €0.2 million (including premium).

c) Debt by maturity, at value on redemption

	December 31, 2005							
	Total	Current 2006	Non-current					
			2007	2008	2009	2010	2011	
Bond issues	3,866	1,302	1,064	—	—	1,500	—	—
Credit facility drawdowns (1)	1,000	—	—	—	—	—	—	1,000
Other bank borrowings	1,441	390	11	1,013	11	12	1	3
Commercial paper	4,353	4,353	—	—	—	—	—	—
Finance leases	38	5	4	4	4	3	6	12
Other borrowings	16	—	—	—	—	—	—	16
Bank overdrafts	378	378	—	—	—	—	—	—
Total debt	11,09	6,428	1,079	1,017	15	1,515	7	1,031
Cash and cash equivalents	(1,249)	(1,249)	—	—	—	—	—	—
Net debt	9,843	5,179	1,079	1,017	15	1,515	7	1,031

(1) Maturities shown for credit facility drawdowns are those of the facility, not the drawdown.

December 31, 2004

	Total	2005	2006	2007	2008	2009	Over 5 years
Total debt	15,892	7,338	1,347	5,563	—	—	1,644
Cash and cash equivalents	(1,840)	(1,840)	—	—	—	—	—
Net debt	14,052	5,498	1,347	5,563	—	—	1,644

The main undrawn confirmed credit facilities at December 31, 2005 break down as follows:

Year of expiry	Undrawn confirmed credit facilities available
2007	2,000
2010	5,500
2012	1,500
Total	9,000

Undrawn, confirmed credit facilities available include:

- €8 billion syndicated credit facility expiring 2010 (€5.5 billion) and 2012 (€2.5 billion, of which €1 billion was drawn down at end 2005 and €1.5 billion is undrawn);
- confirmed bank facilities available for backing commercial paper programs, of which €2 billion was not being used to back drawdowns under French and U.S. commercial paper programs as of December 31, 2005.

In addition, €4.3 billion of confirmed undrawn bank facilities were being used to back outstanding French and U.S. commercial paper programs at December 31, 2005.

As of December 31, 2005, no single counterparty represented more than 8.5% of the Group's confirmed undrawn credit facilities.

d) Debt analysis by interest rate

The table below splits net debt between fixed and floating rate, and by maturity (measured by reference to the contractual repricing date in the case of floating rate), at December 31, 2005. The figures shown represent value on redemption, before taking account of the effects of derivative instruments:

	Total	2006	2007	2008	2009	2010	2011	2012 and later
Fixed-rate debt	2,920	1,264	75	14	14	1,517	7	29
% fixed-rate	30%							
Floating-rate debt (maturity = contractual repricing date)	6,923	6,923	—	—	—	—	—	—
% floating-rate	70%							
Net debt	9,843	8,187	75	14	14	1,517	7	29

Floating-rate debt is generally indexed to euro zone interbank offered rates (Euribor).

In order to reduce the amount and volatility of the cost of debt, the Group has contracted derivative instruments (swaps, caps, combinations of purchases of caps and sales of floors). This has the effect of altering the fixed/floating split of the Group's net debt, and the maturity based on contractual repricing dates:

	Total	2006	2007	2008	2009	2010	2011	2012 and later
Fixed-rate debt	4,855	2,264	10	14	14	1,517	7	1,029
% fixed-rate	49%	33%						
Debt at capped rates	3,250	3,000	250	—	—	—	—	—
Limits [floor/cap]		[2.28%/3.23%	[0%/4%]					
% at capped rates	33%	43%						
Floating-rate debt	1,738	1,738	—	—	—	—	—	—
% floating-rate	18%	24%						
Net debt	9,843	7,002	260	14	14	1,517	7	1,029

The weighted average interest rate of net debt at December 31, 2005 was 3.1% before financial instruments and 3.2% after financial instruments.

After taking account of the derivative instruments in place at December 31, 2005, sensitivity of pre-tax net income for the year ended December 31, 2006 to movements in market interest rates affecting the entire year is as follows:

	Impact on pre-tax net income
+ 100 bp	(37)
+ 25 bp	(10)
- 25 bp	8
- 100 bp	31

e) Net debt by currency

The table below shows net debt by currency at December 31, 2005, before and after taking account of derivative instruments contracted to convert third-party debt into the functional currency of the borrower entity:

	Before derivative instruments	%	After derivative instruments	%
EUR	8,469	86%	10,121	103%
USD	1,555	16%	20	—
Other currencies	(181)	(2%)	(298)	(3%)
Total	9,843	100%	9,843	100%

f) Market value of debt

The market value of debt (excluding derivative instruments) at December 31, 2005 amounted to €9,930 million, compared with a carrying amount of €9,926 million.

Interest rate and currency derivatives contracted for debt management purposes had a positive fair value of €38 million (see Note D.20.).

D.18. Provisions and other non-current liabilities

Provisions and other non-current liabilities at December 31, 2005 and 2004 comprise:

(€ million)	Provisions for pensions and other long-term benefits (D.18.1.)	Restructuring provisions (D.18.2.)	Other provision (D.18.3.)	Other non-current liabilities (D.18.4.)	Total
January 1, 2004	586	5	306	7	904
Impact of Group A acquisition	2,892	144	2,755	402	6,19
Charged during the period	150	48	269	2	469
Provisions utilized	(156)	(8)	(90)	(33)	(287)
Reversals of unutilized provisions	—	—	(107)	—	(107)
Transfers	(1)	(75)	(17)	35	(58)
Translation adjustments	(51)	—	(97)	(37)	(185)
December 31, 2004	3,420	114	3,019	376	6,92
Changes in scope of consolidation	(7)	—	—	—	(7)
Charged during the period	345	89	535	3	972
Provisions utilized	(412)	(26)	(251)	(7)	(696)
Reversals of unutilized provisions	(43)	(5)	(274)	—	(322)
Transfers (2)	78	(26)	176	14	242
Unwinding of discount	—	2	43	6	51
Unrealized foreign exchange gain/loss	—	—	—	(9)	(9)
Translation adjustments	82	3	178	31	294
December 31, 2005	3,463⁽¹⁾	151	3,426	414	7,45

(1) €3,252 million for pension obligations and €211 million for other post-employment benefits (see Note D.18.1).

(2) This line includes, in particular, transfers between current and non-current provisions due to revisions to the expected settlement date of certain obligations.

D.18.1. Provisions for pensions and other benefits

The Group and its subsidiaries have a significant number of pension plans covering the majority of their employees. The specific features (benefit formulas, funding policies and types of assets held) of the plans vary depending on regulations and laws in the particular country in which the employees are located. Several of these plans are defined benefit plans and cover certain members of the Board of Directors as well as employees.

Actuarial valuations of the Group's benefit obligations were computed with the assistance of external valuation experts as of December 31, 2005 and 2004. The calculations incorporate the following:

- Assumptions on staff turnover and life expectancy, specific to each country
- A retirement age of 60 to 65 for a total working life allowing for full rate retirement rights for French employees, and retirement assumptions reflecting local economic and demographic factors specific to foreign employees
- A salary inflation rate ranging from 3% to 4.5% at December 31, 2005 (3% to 4.5% at December 31, 2004)
- An annuity inflation rate ranging from 2% to 3% for the principal countries (1.5% to 3% at December 31, 2004)
- A weighted average rate for healthcare cost inflation of 4.88% at December 31, 2005 (5.14% at December 31, 2004), applied to post-employment benefits
- Discount rates used to determine the present value of projected benefit obligations at the balance sheet date, as shown in the table below:

Discount rate	Pensions and other long-term benefits		Other post-employment benefits	
	2005	2004	2005	2004
<i>Weighted average for all regions:</i>	4.58%	4.91%	5.51%	5.76%
<i>Euro zone</i>	4% or 4.2%*	4.50%	—	—
<i>United States of America</i>	5.50%	5.75%	5.50%	5.75%
<i>United Kingdom</i>	5%	5.50%	5%	5.50%

* depends on the maturity of the plan (4% medium-term, 4.25% long-term).

- The discount rates used are based on the market rates for high quality corporate bonds (AA) for which the duration approximates the expected benefit payments of the plans. The main indexes used are Iboxx Corporates AA in Europe and Moody's Aa bond rate in the United States of America.
- Expected long-term rates of return for plan assets ranging from 3.75% to 11.3% for the year ended December 31, 2005, and from 3% to 10% for the year ended December 31, 2004. The majority of fund assets are invested in Germany, the United States of America and the United Kingdom. The long-term rates of return used are as follows:

Expected long-term rate of return on plan assets	Pensions and other long-term benefits		Other post-employment benefits	
	2005	2004	2005	2004
<i>Weighted average for all regions:</i>	6.65%	6.59%	—	—
<i>Germany</i>	6.25%	7.00%	—	—
<i>United States of America</i>	7.53%	8.12%	—	—
<i>United Kingdom</i>	6.97%	6.92%	—	—

The average long-term rate of return on plan assets was determined on the basis of actual long-term rates of return in the financial markets. These returns vary according to the asset category (equities, bonds, property, other). As a general rule, the Group applies the risk premium concept in assessing the return on equities relative to bond yields.

The table below reconciles the net obligation under Group pension plans with the amounts recognized in the consolidated financial statements as of December 31, 2005 and 2004:

(<i>€ million</i>)	Pensions and other long-term benefits		Other post-employment benefits (healthcare cover)	
	2005	2004	2005	2004
Valuation of obligation:				
Beginning of period	8,225	1,117	182	69
Service cost	238	99	7	3
Interest cost	393	143	11	6
Actuarial (gain)/loss	815	300	31	5
Contributions from plan members	10	7	—	—
Plan amendments	13	8	(19)	—
Translation adjustments	276	(158)	26	(14)
Plan curtailments/settlements	(56)	(4)	(1)	—
Impact of Group A acquisition	—	6,870	—	123
Other changes in scope of consolidation	(4)	—	—	—
Benefits paid	(485)	(157)	(13)	(10)
Obligation at end of period	9,425	8,225	224	182
Market value of plan assets:				
Beginning of period	4,512	503	—	—
Actual return on plan assets	688	155	—	—
Translation adjustments	222	(128)	—	—
Contributions from plan members	9	6	—	—
Employer's contributions	332	79	13	2
Plan curtailments/settlements	(1)	(2)	—	—
Impact of Group A acquisition	—	3,972	—	—
Other changes in scope of consolidation	3	—	—	—
Benefits paid	(415)	(73)	(13)	(2)
Market value of plan assets at end of period	5,350	4,512	—	—
Net amount shown in balance sheet:				
Net obligation	4,075	3,713	224	182
Transitional liability	—	(2)	—	—
Unrecognized past service cost	(61)	(74)	21	2
Unrecognized actuarial gain/(loss)	(762)	(389)	(34)	(12)
Net provision in the balance sheet	3,252	3,248	211	172
Amounts recognized in the balance sheet:				
Pre-funded obligations (D.7.)	(3)	(2)	—	—
Obligations provided (*)	3,252	3,248	211	172
Net amount recognized	3,249	3,246	211	172
Pension cost for the period:				
Service cost	238	99	7	3
Interest cost	393	143	11	6
Expected return on plan assets	(331)	(109)	—	—
Recognition of transitional liability	—	—	—	—
Amortization of past service cost	19	1	—	(1)
Amortization of actuarial (gains)/losses	11	—	(1)	2
Impact of plan curtailments	(42)	6	(1)	—
Pension cost for the period	288	140	16	10

(*) Long-term benefits awarded to employees prior to retirement (primarily discretionary bonuses and long service awards) accounted for €280 million of provisions as of December 31, 2005 (€249 million as of December 31, 2004).

As of December 31, 2005, the present value of obligations in respect of pensions and similar benefits under wholly or partially funded plans was €7,442 million, and the present value of unfunded obligations was €1,983 million (€6,487 million and €1,738 million respectively at December 31, 2004).

In determining the pension cost for the period, the Group amortizes actuarial gains and losses if, at the start of the period, net unrecognized actuarial gains and losses are greater than 10% of the higher of (i) the projected obligation and (ii) the market value of plan assets.

In Germany, the Group is a member of a multi-employer plan. This is a defined contribution plan which covers the current level of annuities. The obligation arising from future increases in annuity rates not covered by plan was included in the pension obligations of Group A as assumed on August 20, 2004 at an amount of €250 million.

The table below shows the sensitivity to changes in healthcare costs of the post-employment benefit obligation in the balance sheet and the pension cost recognized in the income statement:

(€ million)	Sensitivity of assumptions 2005
1% increase in healthcare costs	
Impact on pension cost	3
Impact on obligation in balance sheet	24
1% reduction in healthcare costs	
Impact on pension cost	(1)
Impact on obligation in balance sheet	(20)

The total pension cost (including other post-employment benefits), which amounted to €347 million before the effect of plan curtailments, was recognized on the following lines of the income statement in the year ended December 31, 2005:

- Selling and general expenses: €206 million
- Cost of sales: €81 million
- Research and development expenses: €60 million

The weighted average allocation of funds invested in Group pension plans as of December 31, 2005 and 2004 was as follows:

Asset category (in percentage)	Funds invested	
	2005	2004
Equities	58%	59%
Bonds	41%	40%
Real estate	1%	1%
Total	100%	100%

The target allocation of investments is not significantly different from the actual allocation as of December 2005.

The table below shows the expected cash outflows on pensions and other post-employment benefits over the next ten years:

(€ million)	Pensions and similar benefits
Estimated employer's contribution in 2006	204
Estimated benefit payments:	
2006	497
2007	461
2008	492
2009	506
2010	538
2011 and later	2,992

D.18.2. Restructuring provisions

The table below shows movements in restructuring provisions classified in **Other non-current liabilities** and **Other current liabilities** in the years ended December 31, 2005 and December 31, 2004:

(€ million)	Year ended December 31 2005	Year ended December 31 2004
Balance, beginning of period	478	20
of which:		
• Classified in "Other non-current liabilities"	114	5
• Classified in "Other current liabilities"	364	15
Change in provisions recognized in profit or loss for the period	560	309
Provisions utilized	(470)	(14)
Transfers	(33)	(58)
Unwinding of discount	2	—
Changes in scope of consolidation	(1)	234
Translation difference	26	(13)
Balance, end of period	562	478
of which:		
• Classified in "Other non-current liabilities"	151	114
• Classified in "Other current liabilities"	411	364

Charges to restructuring provisions represent probable future costs arising from restructuring programs decided upon and announced prior to the balance sheet date, the amount of which can be reliably measured (see Note D.27. for details of charges made during 2005).

The portion classified as non-current relates to obligations towards employees, principally in connection with collective early retirement agreements in France.

The portion classified as current includes the residual obligation of €58 million in respect of restructuring initiated by Group A prior to the acquisition, and the residual obligation of €353 million in respect of reorganizations carried out by the Group, primarily in Germany (€50 million), the United States of America (€90 million) and France (€154 million).

D.18.3 Other provisions

Other provisions include provisions for environmental, tax, commercial and product liability risks and litigation.

(€ million)	December 31 2005	December 31 2004
Tax risks	1,664	1,522
Environmental risks	529	452
Product liability risks, litigation and other	1,233	1,045
Total	3,426	3,019

Provisions for tax risks are recorded if the Group is exposed to a probable risk resulting from a tax position adopted by the Group or a subsidiary, and the risk has been quantified at the balance sheet date.

Identified environmental risks are covered by provisions estimated on the basis of the costs the Group believes it will be obliged to meet over a period not exceeding (other than in exceptional cases) 30 years. The Group expects that €260 million of these provisions will be utilized over the period from 2006 through 2011. Movements in the provision during the year ended December 31, 2005 include, in particular, transfers between current and non-current provisions due to revisions to the expected settlement date of certain obligations.

"Product liability risks, litigation and other" mainly comprise provisions for risks relating to antitrust issues, commercial practices, and damages and compensation payable.

A full risk and litigation assessment is performed with the assistance of the Group's legal advisers, and provisions are recorded as required by circumstances, in accordance with the principles described in Note B.12.

D.18.4. Other non-current liabilities

These liabilities include the liability related to Subsidiary C (€12 million at December 31, 2005, €184 million at December 31, 2004).

On June 28, 2001, a financial investor paid \$250 million to acquire preferred shares in Subsidiary C. These preferred shares represented a financial interest of 36.7% in Subsidiary C, and were entitled to preferred remuneration. The Group is the principal shareholder of Subsidiary C, owning 63.3% of the capital and exercising control over its management. Subsidiary C is included in the Group consolidated financial statements using the full consolidation method.

On or after March 10, 2007, the holder of the preferred shares may offer the Group the option of repurchasing them, subject to certain conditions.

The fair value of this financial instrument was €215 million as of December 31, 2005, against €194 million euros as of December 31, 2004. The change in the value of the redeemable partnership interest between these two dates was mainly due to the rise in the value of the U.S. dollar against the euro over the period.

This item also includes an equity derivative instrument valued at €54 million at December 31, 2005 (€57 million at December 31, 2004), as described in Note D.20.2-a).

D.19. Other current liabilities

Other current liabilities as of December 31, 2005 and December 31, 2004 comprise:

(€ million)	December 31 2005	December 31 2004
Taxes payable	1,039	693
Employee-related liabilities	1,490	1,285
Restructuring provisions (D.18.2)	411	364
Interest rate derivatives (D.20.)	1	—
Currency derivatives (D.20.)	47	237
Amounts payable for acquisitions of non-current assets	207	222
Other liabilities	2,348	2,240
Total	5,543	5,041

This item includes the current portion of provisions for litigation, product returns and other risks; amounts due to associates (see Note D.6.); and amounts due to governmental agencies and the healthcare authorities (see Note D.23.).

D.20. Derivative financial instruments and market risks

The table below shows the fair value of derivative instruments as of December 31, 2005:

(€ million)	Non-current assets	Current assets	Total assets	Non-current liabilities	Current liabilities	Total Liabilities	Fair value at Dec. 31, 2005 (net)	Fair value at Dec. 31, 2004 (net)
Currency derivatives	—	257	257	—	47	47	210	454
• operational	—	17	17	—	42	42	(25)	161
• financial	—	240	240	—	5	5	235	243
• net investment hedges	—	—	—	—	—	—	—	50
Interest rate derivatives	5	31	36	—	1	1	35	(84)
Equity derivatives	117	—	117	54	—	54	63	—
Total	122	288	410	54	48	102	308	370

In addition, in 2005 forward currency sales of \$700 million with a negative fair value of €10 million at December 31, 2005 were contracted in connection with the sale of certain assets. The fair value of these contracts is included in **Liabilities related to assets held for sale**.

Objectives of the use of derivative financial instruments

The Group uses derivative instruments primarily to manage operational exposure to the risk of movements in exchange rates, and financial exposure to the risk of movements in interest rates and exchange rates (where debt is not contracted in the functional currency of the borrower or lender entity). Less frequently, the Group uses equity derivatives in connection with asset divestments.

The Group performs periodic reviews of its transactions and contractual agreements in order to identify any embedded derivatives, which are accounted for separately from the host contract in accordance with IAS 39. As of December 31, 2005, the Group had only one material embedded derivative, which relates to the contingent CSL consideration; a description of the accounting treatment of this transaction is provided in Note 2-b.

Counterparty risk

All currency and interest rate hedges, and all investments of surplus cash, are contracted with leading banks. No one counterparty accounts for more than 20% of the Group's currency or interest rate positions.

1. Currency and interest rate derivatives

a) Valuation methods

The Group estimates the fair value of financial instruments using methods and data based on financial market sources, as described below:

• Currency forward and options contracts:

Market data	Source
Spot price	ECB Fixing
Interest rates: less than 1 year	Reuters Mid Money Market
Interest rates: more than 1 year	Reuters Mid Swap
Volatility	Reuters Mid ATM

- As regards forward contracts and currency options: forecast foreign-currency cash flows relating to commercial transactions to be carried out in 2006. The total amount of positions under forward contracts and currency options (only taking into account options in the money) relating to the U.S. dollar, a currency to which the Group's results are particularly sensitive, was \$1,200 million at December 31, 2005 (equivalent to approximately one-quarter of forecast transactions in U.S. dollars for 2006), at an average hedged rate of \$1.20 to the euro. If the actual rate applicable to these transactions in 2006 were to be \$1.25 to the euro, these positions would have a favorable impact of approximately €40 million on consolidated pre-tax net income. If the actual exchange rate applicable in 2006 were to be \$1.15 to the euro, these positions would have a negative impact of approximately €43 million on consolidated pre-tax net income.

The table shows the portfolio of currency instruments in place to manage operational risk as of December 31, 2004:

December 31, 2004	Derivatives designated as cash flow hedges			Derivatives not eligible for hedge accounting	
	Notional amount	Fair value	Notional amount	Fair value	of which recognized in equity
(€ million)					
Forward currency sales	2,638	145	753	66	64
• of which U.S. dollar	1 798	134	614	60	59
Forward currency purchases	1,482	(20)	82	2	—
• of which U.S. dollar	970	(17)	—	—	—
Put options purchased	638	41	364	34	24
• of which U.S. dollar	556	39	301	32	24
Put options written	105	(1)	37	(1)	—
Call options purchased	94	2	37	1	—
• of which U.S. dollar	29	—	—	—	—
Call options written	756	(5)	364	(2)	(1)
• of which U.S. dollar	617	(3)	301	(1)	6
Total	5,713	162	1,637	100	87

c) Currency and interest rate derivatives used to manage financial risk exposures

Some of the Group's financing activities, such as U.S. commercial paper issues and the cash pooling arrangements for foreign subsidiaries outside the euro zone, expose certain entities (in particular the Group parent company) to **financial foreign exchange risk** (i.e. the risk of changes in the value of loans and borrowings denominated in a currency other than the functional currency of the lender or borrower). The net foreign exchange exposure for each currency and entity is hedged by firm financial instruments (usually currency swaps). The tables below show instruments of this type held at December 31, 2005:

December 31, 2005			
(€ million)	Notional amount	Fair value	Expiry
Forward currency purchases	4,763	24	
• of which U.S. dollar	4,071	18	2006
• of which pound sterling	170	—	2006
• of which Mexican peso	130	(1)	2006
• of which Singapore dollar	120	1	2006
• of which Swiss franc	85	—	2006
Forward currency sales	1,032	211	
• of which U.S. dollar	885	211	2007
Total	5,795	235	

December 31, 2004			
(€ million)	Notional amount	Fair value	Expiry
Forward currency purchases	4,302	(71)	
• of which U.S. dollar	3,533	(66)	2005
Forward currency sales	2,052	315	
• of which U.S. dollar	1,744	316	2005 and 2007
Total	6,354	244	

The Group's **interest rate risk** exposure arises from the fact that most of its debt is floating-rate (credit facilities, commercial paper and floating rate notes), predominantly in euros. To limit risk and optimize the cost of its short-term and medium-term debt, the Group uses interest rate swaps, cross-currency swaps, and interest rate options (purchases of caps, or combined purchases of caps and sales of floors). The table below shows instruments of this type held at December 31, 2005:

Average rate	Notional amount by expiry date, as of December 31, 2005				Fair value	Of which derivatives designated as fair value hedges		Of which derivatives designated as cash flow hedges		
	2006	2007	2012	Total		Notional amount	Fair value	Notional amount	Fair value	of which recognized in equity
(€ million)										
Interest rate swaps: receive fixed rate (€)	3.49%	1,250	—	—	1,250	29	640	19	—	—
Interest rate swaps: pay fixed rate (€)	2.90%	2,000	—	1,000	3,000	5	—	—	2,000	5
Purchases of caps (€)	3.45%	1,500	250	—	1,750	—	—	—	1,500	—
Sales of caps (€)	4.33%	500	—	—	500	—	—	—	—	—
Collars (€)	(2.31%-3.07%)	2,000	—	—	2,000	—	—	—	1,750	—
Cross currency swaps										
- receive CHF at 1-month Libor, pay € at 3-month Euribor		52	—	—	52	—	—	—	—	—
- pay € at 3-month Euribor, receive CHF at 1.98%		—	64	—	64	(1)	—	—	—	—
Total		7,302	314	1,000	8,616	33	640	19	5,250	5

For an analysis of the effect of financial instruments on the structure of the Group's debt, and of the Group's sensitivity to interest rates, see Note D.17.

The portfolio of interest rate derivative instruments at December 31, 2004 was as follows:

Average rate	Notional amount by expiry date, as of December 31, 2004				Fair value	Of which derivatives designated as fair value hedges		Of which derivatives designated as cash flow hedges		
	2005	2006	2007	Total		Notional amount	Fair value	Notional amount	Fair value	of which recognized in equity
(€ million)										
Interest rate swaps: receive fixed rate (€)	3.50%	4	1,250	—	1,254	42	1,254	42	—	—
Interest rate swaps: pay fixed rate (€)	2.50%	750	2,000	—	2,750	(4)	—	—	2,750	(4)
Interest rate swaps: floating/floating rate										
€ average positive margin of:	32bp	500	400	—	900	2	—	—	—	—
€ average positive margin of:	53 bp	—	1,047	—	1,047	—	—	—	—	—
Purchases of caps (€)	3.73%	—	1,602	250	1,852	3	—	—	1,750	3
Purchases of caps (\$)	4.50%	—	367	—	367	—	—	—	—	—
Sales of caps (€)	4.33%	—	500	—	500	—	—	—	—	—
Collars (€)	(2.26%-3.03%)	500	2,000	—	2,500	(2)	—	—	2,250	(2)
Cross currency swaps										
- EUR/USD 5.56% / 6.25%		220	—	—	220	(127)	—	—	—	—
- Pay € at 3-month Euribor, receive CHF at 1.98%	—	—	—	65	65	2	—	—	—	—
Total		1,974	9,166	315	11,455	(84)	1,254	42	6,750	(3)

2. Equity derivatives

a) Equity swap

On May 2, 2003, Group A sold 17,751,610 shares of its investment in Company R to a bank, and at the same time entered into an equity swap contract with the purchaser. This transaction, which reduced the interest held by Group A in Company R to around 15%, is a firm and final sale under which the purchaser immediately obtained full and unrestricted ownership of the shares (including voting rights and dividends). The transaction does not allow for the shares to be returned to the Group by any means. No gain on disposal was generated by the transaction.

The equity swap mentioned above is treated as an over-the-counter derivative instrument. As a result, unrealized gains and losses on the swap must be estimated and recognized in the income statement at each balance sheet date. The unrealized loss on the swap as of December 31, 2005 was €54 million (December 31, 2004: €57 million).

b) Contingent CSL consideration

Group A sold one of its subsidiaries to CSL on March 31, 2004. The sale price included additional payments contingent upon the performance of CSL shares. The Group will receive \$125 million if the CSL share price (calculated on the basis of an average price weighted for trading volumes) is greater than AUD28 during a period from October 1, 2007 through March 31, 2008. The Group will receive a further \$125 million if the CSL share price (calculated on the same basis and over the same period) is greater than AUD35. CSL Ltd may opt to settle these amounts in shares. At December 31, 2005, based on a CSL share price of AUD42.50, the fair value of this instrument was \$137 million (compared with \$78 million at December 31, 2004).

D.21. Contractual obligations and other commercial commitments

The Group's contractual obligations and other commercial commitments as of December 31, 2005 comprised:

(€ million)	Payments due by period				
	Total	Under 1 year	1-3 years	3-5 years	Over 5 years
Undrawn confirmed credit facilities (1)	(9,780)	(2,680)	—	(5,500)	(1,600)
• Finance lease obligations (including interest)	45	7	10	9	19
• Operating lease obligations	1,032	277	358	144	253
• Irrevocable purchase obligations	792	332	119	55	286
• Guarantees:					
- given	243	107	58	31	47
- received	(48)	(36)	(7)	—	(5)
• Other commercial commitments	562	206	84	70	202
Sub-Total	2,626	893	622	309	802
Total	(7,154)	(1,787)	622	(5,191)	(798)

(1) These amounts include commitments received by some operational subsidiaries.

Leases

Finance leases

Future minimum lease payments due under finance leases as of December 31, 2005 amounted to €45 million, including interest of €6 million. The payment schedule is as follows:

(€ million)	Interest	Principal	Total
2006	1	6	7
2007	1	4	5
2008	1	4	5
2009	1	4	5
2010	1	3	4
2011 and later	1	18	19
Total	6	39	45

Operating leases

The Group leases certain of its properties and equipment used in the ordinary course of business under operating leases. Future minimum lease payments due under non-cancelable operating leases as of December 31, 2005 amounted to €1,032 million. The payment schedule is as follows:

(€ million)	Dec. 31, 2005
2006	277
2007	232
2008	126
2009	82
2010	62
2011 and later	253
Total	1,032

Rental expense recognized by the Group in the year ended December 31, 2005 amounted to €263 million (2004: €158 million).

Irrevocable purchase obligations

These mainly comprise irrevocable commitments (net of payments on account) to suppliers of property, plant and equipment, and irrevocable commitments to purchase goods and services.

Commercial commitments

This includes commitments to third parties under collaboration agreements. In pursuance of its strategy, the Group acquires rights to products or technologies. Such acquisitions may be made in various contractual forms: acquisitions of shares, loans, license agreements, joint development and co-marketing. They may also involve upfront payments on signature of the agreement, and development milestone payments.

Some of these complex agreements include firm and unconditional undertakings to finance research programs in future years, and payments contingent upon completion of development milestones by our alliance partners or upon the granting of approvals or licenses.

The main such collaboration agreements are:

- Agreement with Company R: In January 2005, the Group reaffirmed its commitment to develop the VEGF Trap program in oncology, in collaboration with Company R. The companies will evaluate the VEGF Trap in a variety of cancer types. The Group made a clinical development milestone payment of \$25 million under this agreement in 2004. If the program results in a commercially marketed product, Company R will receive an additional payment of \$40 million.

At the end of December 2005, the VEGF Trap collaboration with Company R was extended to Japan. The Group will pay Company R \$25 million; milestone payments linked to potential marketing approvals in Japan; and royalties on VEGF Trap sales in Japan. Under the terms of the agreement, the Group will pay 100% of the development costs of the VEGF Trap; once a VEGF Trap product starts to be marketed, Company R will repay 50% of the development costs (originally paid by the Group) out of its share of the profits, including royalties paid in Japan.

- Agreement between the Group and the U.S. government, signed in April 2005, to speed the production process for new influenza vaccines and design a production facility for cell-culture vaccines. This agreement was for an amount of \$97 million.
- Agreement between the Group and the U.S. government, signed in September 2005, for the production of a vaccine against a specific strain of avian influenza, under which the Group will receive \$100 million for vaccines delivered. At the start of 2006, the agreement was extended to include additional production worth \$50 million.

The Group has initiated similar projects in Europe and the rest of the world.

- License agreement between the Group and BD, signed in October 2005, for the development of a vaccine micro-administration technology.
- Collaboration agreement with a third party on the development of angiogenesis inhibitors, under which payments for the first product could reach \$32 million.
- Collaboration agreement with IDM signed in 2001, under which IDM granted the Group 20 development options on current and future research and development programs. For each option that leads to a commercially marketed product, IDM could receive a total amount of between €17 million and €32 million depending on the potential of the market, plus reimbursement of the development costs. Contractually, the Group may suspend the development program for each option exercised at any time and without penalty. As of December 31, 2005, the Group had exercised only one option, relating to a program for the treatment of melanoma.

Because of the uncertain nature of development work, it is impossible to predict (i) whether the Group will exercise further options for products, or (ii) whether the expected milestones will be achieved, or (iii) the number of compounds that will reach the relevant milestones. It is therefore impossible to estimate the maximum aggregate amount that the Group will actually pay in the future under existing collaboration

Given the nature of its business, it is highly unlikely that the Group will exercise all options for all products or that all milestones will be achieved.

- Collaboration agreement with a third party signed in June 2003, under which the Group obtained rights relating to the development and worldwide marketing of an agent used in the treatment of type 2 diabetes. Under the agreement, the Group is responsible for the development of this compound, and could, if marketing approvals are obtained, be required to pay the third party a total of €60 million over the next five years.
- Collaboration agreements with certain other third parties, under which the Group may be required to make contingent payments of approximately €26 million over the next five years.

Commercial commitments relating to the acquisition of commercial rights:

- On July 5, 2005, the Group acquired all the commercial rights to one specified product from Company D and a partnership jointly held by Company D and the Group. Given their long-standing association, Company D and the Group will now work together on the manufacture and co-promotion of this product in order to ensure a successful launch for the product on the Japanese market. The product will begin to be marketed in Japan as soon as it is registered on the NHI (National Health Insurance) price list, expected to be during the second quarter of 2006. Marketing approval for Japan was obtained in January 2006. No payment was made during 2005.

Guarantees given

These comprise €243 million of surety bonds (€275 million at December 31, 2004).

Guarantees received

These mainly comprise surety bonds.

D.22. Legal and arbitral proceedings

In the ordinary course of its business, the Group is involved in lawsuits concerning various aspects of its business. The litigation typically falls under the following categories:

- Products
- Patents
- Compliance—*Pricing and Marketing Practices*
- Compliance—*Antitrust litigation*
- Contingencies Arising from Certain Business Divestitures; and
- Other litigation and arbitration

The Group records a provision where it has a present obligation, whether legal or constructive, as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the outflow of resources.

D.23. Provisions for discounts, rebates and sales returns

The adjustments between gross sales and net sales, as described in Note B.13, are recognized either as provisions or as reductions in accounts receivable, depending on their nature.

The table below shows the movements in these items from January 1, 2005 through December 31, 2005:

(€ million)	Government and State programs (1)	Managed Care and GPO programs (2)	Charge-back Incentives	Rebates and discounts	Sales returns	Other deductions	Total
Balance, beginning of period	208	125	23	135	132	18	641
Current provision related to current period	462	390	608	689	173	126	2,448
Net change in provision related to prior period sales	(9)	—	(2)	—	(2)	—	(13)
Payments made	(432)	(371)	(580)	(684)	(160)	(87)	(2,31)
Translation differences	31	21	9	7	21	6	95
Balance, end of period	260	165	58	147	164	63	857

(1) Primarily the U.S. government's Medicare and Medicaid programs.

(2) Rebates and other price reductions, primarily granted to healthcare authorities in the United States of America.

D.24. Personnel costs

Total personnel costs break down as follows:

(€ million)	Year ended December 31, 2005
Salaries	(4,551)
Social security charges	(1,048)
Agency staff	(177)
Share-based payment	(199)
Employee share ownership plan	(31)
Pension expense: defined-contribution plans	(166)
Pension expense: defined-benefit plans	(347)
Other employee benefits	(344)
Total	(6,863)

The total number of employees as of December 31, 2005 is 97,181 (compared with 96,439 as of December 31, 2004).

Employee numbers by function were as follows:

	December 31, 2005	December 31, 2004
Production	30,909	30,735
Research and development	17,636	17,191
Sales force	35,030	32,888
Marketing and support functions	13,606	15,625
Total	97,181	96,439

D.25. Other current operating income

Other current operating income comprises:

<i>(€ million)</i>	Year ended December 31, 2005
Share of profits received from alliance partners	250
Net foreign exchange loss on operating items	(79)
Other	90
Total	261

The share of profits received from alliance partners includes the alliance with PGP for the development and marketing of a product on a worldwide basis excluding Japan (see Note C.2.).

In 2004, in addition to the share of profits received from alliance partners, this caption also included a net foreign exchange gain on operating items, amounting to €142 million.

D.26. Other current operating expenses

Other current operating expenses mainly comprise shares of profits due to alliance partners under the related agreements

D.27. Restructuring costs

Restructuring costs recognized in 2005 amount to €972 million (2004: €679 million), and comprise:

- employee-related expenses of €696 million (2004: €289 million);
- compensation for early termination of contracts of €92 million (2004: €76 million);
- expenses related to the abandonment of software of €22 million (2004: €139 million);
- other restructuring costs of €162 million (2004: €175 million).

D.28. Other operating income and expenses

Other operating income and expenses for the years ended December 31, 2005 and 2004 break down as follows:

<i>(€ million)</i>	Year ended December 31, 2005	Year ended December 31, 2004
Net gains on disposals	102	206
Other	(23)	(1)
Total	79	205

In 2005, net gains on disposals include a gain of €70 million arising on the sale of the oral hygiene product ranges to PGP under the put option agreement signed on October 8, 2004.

The other gains on disposal recognized in 2005 relate to disposals of trademarks (€9 million), patents, and other pharmaceutical rights.

In 2004, net gains on disposals included the gain on the divestment of two products and their related assets.

The *Other* line mainly comprises movements in provisions for risks.

D.29. Financial income and expenses

The tables below show the main components of financial income and expenses:

D.29.1. Financial expenses

<i>(€ million)</i>	Year ended December 31, 2005	Year ended December 31, 2004
Interest expense on debt	(444)	(165)
Unwinding of discount on provisions	(47)	(1)
Fair value losses on financial assets	(24)	(4)
Provisions for impairment of financial assets	(17)	(10)
Other	—	(59)
Total financial expenses	(532)	(239)

D.29.2. Financial income

<i>(€ million)</i>	Year ended December 31, 2005	Year ended December 31, 2004
Interest income	76	59
Foreign exchange gains (non-operating)	64	2
Fair value gains on financial instruments	49	11
Net gain on disposals of financial assets	94	—
Other	4	52
Total financial income	287	124

D.30. Income tax expense

The Group has opted for tax consolidations in a number of countries, principally France, Germany, the United Kingdom and the United States of America.

Income before tax and the corresponding tax charge for the years ended December 31, 2005 and 2004 were as follows:

<i>(€ million)</i>	Year ended December 31, 2005			Year ended December 31, 2004	
	Domestic	Rest of the world	Impact of the acquisition of Group A ⁽¹⁾	Total	Total
Income before tax	1,784	6,144	(5,285)	2,643	2,311
Income tax	(362)	(2,080)	1,965	(477)	(479)

(1) These amounts represent the impact on income before tax and on deferred taxes recognized in the income statement of (i) amortization and impairment charged on the remeasurement of intangible assets and (ii) the effect of the workdown on inventories remeasured at fair value, related to the acquisition of Group A.

Income tax expense for the years ended December 31, 2005 and 2004 comprises:

<i>(€ million)</i>	Year ended December 31, 2005	Year ended December 31, 2004
Current taxes	(2,724)	(1,535)
Deferred taxes	2,247	1,056
Total	(477)	(479)

The difference between the effective tax rate and the standard domestic corporate income tax rate applicable for the years ended December 31, 2005 and 2004 is explained as follows:

<i>(as %)</i>	Year ended December 31, 2005	Year ended December 31, 2004
Domestic tax rate	35	35
Impact of income tax at reduced rate on royalties	(14)	(7)
Impact of changes in domestic tax rates in 2004	—	(3)
Other	(3)	(4)
Effective tax rate	18	21

The impact of lower-rate tax on royalties of -14% in 2005, compared with -7% in 2004, is due to (i) a reduction in the lower rate of tax from 19% to 15% (before contributions) and (ii) the inclusion of Group A over 12 months in 2005 compared with 4 months in 2004.

"Other" includes the impact of (i) the difference between the domestic tax rate and tax rates applicable in other countries and (ii) the reassessment of certain of the Group's tax exposures.

The effective tax rate incorporates the effect of the amortization and impairment of intangible assets (other than software) over 12 months in 2005 compared with 4 months in 2004. Deferred taxes on this amortization and impairment are charged on a higher average rate than the Group's overall effective tax rate.

Income taxes actually paid by the Group in the year ended December 31, 2005 amounted to €2,669 million, compared with €1,725 million in 2004.

D.31. Share of profit/loss of associates

This caption mainly comprises the share of co-promotion profits attributable to the Group for territories covered by entities majority-owned by BMS (see Note C.1.). The share of profits of associates generated by the BMS alliance in 2005 was €647 million, before deducting the tax effect of €243 million (2004: €581 million, tax effect €220 million).

It also includes the share of profits from other associates (€23 million in 2005, €48 million in 2004: see Notes D.6. and E.2.). These figures incorporate the effect of the Group A acquisition (workdown of acquired inventories, amortization and impairment of intangible assets).

D.32. Minority interests

This line includes the share of co-promotion profits attributable to BMS for territories covered by entities majority-owned by the Group (see Note C.1.). The amount involved in 2005 was €300 million (against: €257 million in 2004); there is no tax effect, because BMS receives its share before tax.

It also includes the share of net income attributable to the other minority shareholders (€49 million in 2005, €13 million in 2004), and the portion attributable to minority shareholders of depreciation and amortization charged on fair value remeasurements of the acquired assets and liabilities of Group A (€14 million in 2005, €15 million in 2004).

In 2004, this line included the loss of €4 million attributable to the minority shareholders of a subsidiary, due mainly to their share in the depreciation and amortization charged on the fair value remeasurements to the acquired assets and liabilities of Group A (see Note D.15.).

D.33. Related party transactions

The Group has not entered into any transaction with any member of the Board of Directors or Senior Management, or with any shareholder holding more than 5% of the share capital, other than in the ordinary course of business. In particular, financial relations with the Total group were immaterial as of December 31, 2005 and 2004.

For details of transactions with related companies, refer to Note D.6.

The table below shows, by type, compensation paid to the Group's principal executives (i.e. the 19 members of the Executive Committee as of December 31, 2005 plus, for post-employment benefits, certain members of the Board of Directors):

<i>(€ million)</i>	Year ended December 31, 2005
Short-term benefits (1)	25
Post-employment benefits (2)	12
Share-based payment (3)	11
Total	48

(1) Compensation and employer's social security charges.

(2) Estimated pension cost, calculated in accordance with IAS 19.

(3) Stock option expense (computed using the Black & Scholes model), and expense relating to the discount offered under the employee share ownership plan.

D.34. Split of net sales

The Group is not dependent on any single customer or group of customers for its sales.

Products are sold throughout the world to a wide range of customers including pharmacies, hospitals, chain warehouses, governments, physicians, wholesalers and other distributors.

D.35. Segment information

D.35.1 Business segments

The Group has two business segments: Pharmaceuticals and Human Vaccines.

Adjusted net income

"Adjusted net income", reported in segment information, is an internal performance indicator, defined as net income adjusted for the material impacts of the application of purchase accounting to the Group A deal and for certain costs associated with the deal.

Management uses adjusted net income as an internal performance indicator, as a significant factor in determining variable compensation, and as a basis for determining the dividend policy of the new Group.

The main adjustments between net income and adjusted net income are:

- elimination of expenses arising on the workdown of acquired inventories remeasured at fair value, net of tax;
- elimination of expenses arising on amortization and impairment of Group A intangible assets (acquired in-process R&D and acquired product rights), net of tax and minority interests;
- elimination of expenses arising from the impact of the acquisition of Group A on equity investees (workdown of acquired inventories, amortization and impairment of intangible assets, and impairment of goodwill);
- elimination of any impairment losses charged against the goodwill generated by the acquisition of Group A.

The Group also excludes from adjusted net income integration and restructuring costs (net of tax) incurred specifically in connection with the acquisition of Group A.

Adjusted net income for the years ended December 31, 2005 and 2004, is as follows:

(€ million)	Year ended December 31, 2005	Year ended December 31, 2004
Consolidated net income	2,258	1,986
Material accounting adjustments related to the acquisition of Group A:	3,462	1,135
• elimination of expense arising on the workdown of acquired inventories remeasured at fair value, net of tax	248	342
• elimination of expenses arising on amortization and impairment of Group A intangible assets, net of tax and minority interests	3,156	795
• elimination of expenses arising from the impact of the acquisition of Group A on equity investees (workdown of acquired inventories, amortization and impairment of intangible assets, and impairment of goodwill)	58	(2)
• elimination of impairment losses charged against the goodwill generated by the acquisition of Group A	—	—
Elimination of acquisition-related integration and restructuring charges, net of tax:	615	406
Adjusted consolidated net income (unaudited)	6,335	3,527

Income statement information by segment

The table below shows the principal income statement indicators by business segment:

(€ million)	Year ended December 31, 2005			Year ended December 31, 2004		
	Pharma- ceuticals	Vaccines	Group consolidated	Pharma- ceuticals	Vaccines	Group consolidated
Net sales	25,249	2,062	27,311	14,188	683	14,871
Other revenues	1,143	59	1,202	849	13	862
Research and development expenses	(3,725)	(319)	(4,044)	(2,271)	(118)	(2,389)
Selling and general expenses	(7,832)	(418)	(8,250)	(4,485)	(115)	(4,600)
Amortization of intangibles	(3,756)	(281)	(4,037)	(1,441)	(140)	(1,581)
Operating income – current	4,565	188	4,753	2,928	(28)	2,900
Impairment of property, plant & equipment and intangibles	(970)	(2)	(972)	—	—	—
Operating income	2,702	186	2,888	2,454	(28)	2,426
Financial expenses	(498)	(34)	(532)	(219)	(20)	(239)
Financial income	283	4	287	124	—	124
Income tax expense	(427)	(50)	(477)	(494)	15	(479)
Share of profit/loss of associates (1)	482	(55)	427	410	(1)	409
Minority interests	(335)	—	(335)	(254)	(1)	(255)
Net income	2,207	51	2,258	2,021	(35)	1,986
Adjusted consolidated net income (2) (unaudited)	5,903	432	6,335	3,416	111	3,527

(1) Financial information for associates is included under “Pharmaceuticals”, except for associates specifically involved in the “Vaccines” business.

(2) See definition of “Adjusted net income” above.

Inter-segment transactions are not material. Transfer prices between segments are determined on an arm’s length basis.

Assets and liabilities by segment

Assets and liabilities by business segment are as follows:

	December 31, 2005			December 31, 2004		
	Pharmaceuticals	Vaccines	Group consolidated	Pharmaceuticals	Vaccines	Group consolidated
<i>(€ million)</i>						
Investments in associates *	1,928	549	2,477	2,322	609	2,931
Segmental assets	72,381	6,314	78,695	72,090	5,930	78,020
Unallocated assets	—	—	5,486	—	—	4,456
Total assets	74,309	6,863	86,658	74,412	6,539	85,407
Acquisitions of property, plant & equipment and intangible assets	974	169	1,143	711	43	754
Segmental liabilities	14,908	798	15,706	13,936	672	14,608
Unallocated liabilities	—	—	24,126	—	—	29,276
Total liabilities (excluding shareholders' equity)	14,908	798	39,832	13,936	672	43,884

* Financial information for associates is included under "Pharmaceuticals", except for associates specifically involved in the "Vaccines" business.

D.35.2. Information by geographical segment

Information by geographical segment for the year ended December 31, 2005 is as follows:

	Total	Europe	United States of America	Other countries	Unallocated costs ⁽¹⁾
<i>(€ million)</i>					
Net sales	27,311	12,134	9,566	5,611	—
Operating income – current (2)	4,753	4,360	3,900	1,804	(5,311)
Acquisitions of property, plant and equipment and intangible assets	1,143	896	162	85	—
Total assets	86,658	36,845	34,990	14,823	—
Of which non-current assets (3)	70,442	27,592	31,201	11,649	—

(1) Unallocated costs consist mainly of fundamental research and worldwide development of pharmaceutical molecules, and part of the cost of support functions.

(2) After amortization of intangible assets (€4,037 million).

(3) Including €30,234 million of goodwill and €30,229 million of intangible assets.

Information by geographical segment for the year ended December 31, 2004 was as follows:

	Total	Europe	United States of America	Other countries
<i>(€ million)</i>				
Net sales	14,871	7,266	4,658	2,947
Acquisitions of property, plant and equipment and intangible assets	754	695	32	27
Total assets	85,407	37,927	33,183	14,297
Of which non-current assets	71,360	29,478	29,926	11,956

D.36. Events subsequent to the balance sheet date

Divestment

On January 13, 2006, the Group announced the signature of an agreement to transfer its rights to an inhaled human insulin product to a third party. The terms of the 1998 alliance between Group A and the third party to jointly develop, manufacture and market this product included a change of control clause, which the third party decided to activate following the acquisition of Group A.

Under the terms of the agreement signed on January 13, 2006, the Group will sell to the third party its share in the worldwide rights for the development, manufacture and marketing of the product, along with its interest in the joint venture which owns the insulin manufacturing facility used in the production of the product.

In return for the transfer of these assets and rights, the Group will receive a payment of \$1.3 billion net of local taxes. Completion of the deal is subject to various conditions, one of which – approval by the local antitrust authorities – was fulfilled in January 2006. The sale is expected to be completed during the first quarter of 2006.

F. IFRS RECONCILIATION NOTE

F.1. Reconciliation at January 1, 2004

F.1.1. Note on the reconciliation of the balance sheet

The table below shows the impact of transition to IFRS on the balance sheet at the transition date.

(€ million)	December 31, 2003 Previous GAAP	IFRS transition adjustments and reclassifications	January 1, 2004 IFRS
ASSETS			
Property, plant and equipment	1,449	—	1,449
Goodwill	124	—	124
Intangible assets	897	26	923
Investments in associates	126	161	287
Financial assets—non-current	116	(44)	72
Deferred tax assets	472	46	518
Non-current assets	3,184	189	3,373
Inventories	799	(1)	798
Accounts receivable	1,491	(44)	1,447
Other current assets	897	(127)	770
Financial assets—current	2,980	(458)	2,522
Cash and cash equivalents	398	(12)	386
Current assets	6,565	(642)	5,923
TOTAL ASSETS	9,749	(453)	9,296
LIABILITIES & EQUITY			
Shareholders' equity	6,323	(713)	5,610
Minority interests	18	50	68
Total equity	6,341	(663)	5,678
Long-term debt	53	—	53
Provisions and other non-current liabilities	754	151	905
Deferred tax liabilities	9	89	98
Non-current liabilities	816	240	1,056
Accounts payable and accrued expenses	657	(17)	640
Other current liabilities	1,620	(13)	1,607
Short-term debt and current portion of long-term debt	315	—	315
Current liabilities	2,592	(30)	2,562
TOTAL LIABILITIES & EQUITY	9,749	(453)	9,296

Balance sheet reconciliation at January 1, 2004

(€ million)	Elimination of treasury shares (1)	Fair value of financial instruments (2)	Discounting of long-term provisions (3)	Deferred taxes (4)	Share-based payment (5)	Actuarial losses on pension obligations (6)	Capitalization of acquired and internal R&D (7)	Other adjustment (8)	BMS reclasses (9)	Total IFRS transition adjustments and reclassifications
ASSETS										
Property, plant and equipment	—	—	—	—	—	—	—	—	—	—
Goodwill	—	—	—	—	—	—	—	—	—	—
Intangible	—	—	—	—	—	—	26	—	—	26
Investments in associates	—	—	—	—	—	—	—	7	154	161
Financial assets – non-current	—	6	—	—	—	(50)	—	—	—	(44)
Deferred tax assets	—	2	—	(21)	—	68	(3)	—	—	46
Non-current assets	—	8	—	(21)	—	18	23	7	154	189
Inventories	—	—	—	—	—	—	—	(1)	—	(1)
Accounts receivable	—	(21)	—	—	—	—	—	(23)	—	(44)
Other current assets	—	(24)	—	—	—	—	—	—	(103)	(127)
Financial assets – current	(613)	156	—	—	—	—	—	(1)	—	(458)
Cash and cash equivalents	—	—	—	—	—	—	—	(12)	—	(12)
Current assets	(613)	111	—	—	—	—	—	(37)	(103)	(642)
TOTAL ASSETS	(613)	119	—	(21)	—	18	23	(30)	51	(453)
LIABILITIES & EQUITY										
Shareholders' equity	(628)	76	4	(44)	—	(139)	17	1	—	(713)
Minority interests	—	—	—	—	—	—	—	(1)	51	50
Total equity	(628)	76	4	(44)	—	(139)	17	—	51	(663)
Long-term debt	—	—	—	—	—	—	—	—	—	—
Provisions and other non-current liabilities	—	—	(6)	—	—	157	—	—	—	151
Deferred tax liabilities	15	43	2	23	—	—	6	—	—	89
Non-current liabilities	15	43	(4)	23	—	157	6	—	—	240
Liabilities related to operations held for sale	—	—	—	—	—	—	—	—	—	—
Accounts payable and accrued expenses	—	8	—	—	—	—	—	(25)	—	(17)
Other current liabilities	—	(8)	—	—	—	—	—	(5)	—	(13)
Short-term debt, current portion of long-term debt	—	—	—	—	—	—	—	—	—	—
Current liabilities	—	—	—	—	—	—	—	(30)	—	(30)
TOTAL LIABILITIES & EQUITY	(613)	119	—	(21)	—	18	23	(30)	51	(453)

IFRS transition adjustments had the effect of reducing **Shareholders' equity** by €713 million and increasing **Minority interests** by €50 million at the transition date.

- (1) The carrying amount of treasury shares (net of provisions for impairment), i.e. €613 million, was deducted from **Shareholders' equity**, along with the related increase of €15 million in **Deferred tax liabilities**.
- (2) Recognition of financial instruments at fair value increased financial assets by €117 million. After an increase of €41 million in deferred tax liabilities, the net increase in **Shareholders' equity** was €76 million.

This increase related to derivative instruments (€111 million, in current assets) and to available-for-sale financial assets (€6 million, in **Financial assets – non-current**). The rise in non-current financial assets represents the recognition of changes in the fair value (unrealized gains) of participating interests, which are classified as available-for-sale financial assets under IAS 39. The increase of €111 million in current assets is due to the remeasurement of currency instruments designated as cash flow hedges.

- (3) Discounting of long-term provisions resulted in an adjustment to **Provisions and other non-current liabilities** of €6 million, with a related deferred tax liability of €2 million.
- (4) The deferred tax adjustment was mainly due to the recognition of deferred taxes on temporary differences arising on investments in associates and joint ventures. This led to an increase in **Deferred tax liabilities** of €23 million and a reduction in **Deferred tax assets** of €21 million.
- (5) Share-based payment had no impact on shareholders' equity in the opening balance sheet because the expense (related to the fair value of stock option plans) charged to the income statement was taken against shareholders' equity.

For information purposes, the cumulative value of services received from employees under stock option plans not wholly vested as of January 1, 2004 was estimated at €131 million.

- (6) As permitted by IFRS 1, the Group recognized all previously unrecognized actuarial gains and losses related to pensions, other post-employment benefits and jubilees. This led to an increase of €157 million in **Provisions and other non-current liabilities** and a decrease of €50 million in the receivable recorded in respect of overfunding of pension plans in **Financial assets – non current**. Together with a deferred tax asset of €68 million, the recognition of actuarial gains and losses resulted in a net reduction in **Shareholders' equity** of €139 million.
- (7) As of the transition date, the Group capitalized internal second-generation process development costs meeting IAS 38 criteria, milestone payments related to external research and development projects, and acquired generics files; the total amount of €26 million (net of amortization) was recorded in **Intangible assets**. As of January 1, 2004, the amount of €26 million related solely to the Group.

The Group recognizes milestone payments for external in-process research and development whatever the phase, provided that they give a right to compounds under development or access to specific technologies or databases. Amortization begins as of the date regulatory marketing approval is obtained. After the related €9 million deferred tax effect, the net impact of the capitalization of research and development expenses on **Shareholders' equity** amounted to €17 million.

- (8) Other adjustments relate to:
 - The combined negative effect of all the adjustments described above on **Minority interests**, amounting to €1 million.
 - The effect of the adoption of the equity method of accounting for joint ventures, previously consolidated by the proportionate method. Consolidated amounts relating to these entities were reclassified in the balance sheet to **Investments in associates**, increasing this item by €7 million (with no impact on shareholders' equity).
- (9) For the alliance with BMS, the Group made the following reclassifications:
 - The share of net assets attributable to BMS, relating to entities majority-owned by the Group, was reclassified under **Minority interests** (€51 million).
 - The share of net assets attributable to the Group, relating to entities majority-owned by BMS, was reclassified under **Investments in associates** (€154 million).

F.1.2. Note on the reconciliation of shareholders' equity at January 1, 2004

(€ million)	Share capital	Additional paid-in capital, reserves & retained earnings	Treasury shares	Stock options	Items recognized directly in equity	Translation differences	Total Group	Minority interests	Total equity
Balance at January 1, 2004 – Previous GAAP	1,466	7,269	(2,008)	—	—	(404)	6,323	18	6,341
Reclassification of cumulative translation differences at transition date	—	(404)	—	—	—	404	—	—	—
Elimination of treasury shares (IAS 32)	—	—	(628)	—	—	—	(628)	—	(628)
Fair value of financial instruments (IAS 39)									
• Available-for-sale financial assets: fair value remeasurement	—	—	—	—	4	—	4	—	4
• Derivative instruments: fair value remeasurement	—	6	—	—	66	—	72	—	72
Discounting of long-term provisions (IAS 37)	—	4	—	—	—	—	4	—	4
Deferred taxes (IAS 12)	—	(44)	—	—	—	—	(44)	—	(44)
Share-based payment (IFRS 2)	—	(131)	—	131	—	—	—	—	—
Actuarial losses on pension obligations recognized in equity (IFRS 1)	—	(139)	—	—	—	—	(139)	—	(139)
Capitalization of research and development (IAS 38)	—	17	—	—	—	—	17	—	17
Other adjustments	—	1	—	—	—	—	1	(1)	—
BMS reclassification	—	—	—	—	—	—	—	51	51
Total IFRS transition adjustments and reclassifications	—	(690)	(628)	131	70	404	(713)	50	(663)
Balance at January 1, 2004 – IFRS	1,466	6,579	(2,636)	131	70	—	5,610	68	5,678

F.2. Reconciliation at December 31, 2004

F.2.1. Note on the reconciliation of the balance sheet at December 31, 2004

(€ million)	December 31, 2004 Previous GAAP	IFRS transition adjustments and reclassifications, and revisions of estimates ⁽¹⁾	December 31, 2004 IFRS
ASSETS			
Property, plant and equipment	5,886	6	5,892
Goodwill	23,475	4,863	28,338
Intangible assets	29,600	3,629	33,229
Investments in associates	2,404	527	2,931
Financial assets – non-current	940	30	970
Deferred tax assets	1,925	159	2,084
Non-current assets	64,230	9,214	73,444
Inventories	3,058	(26)	3,032
Accounts receivable	4,501	(47)	4,454
Other current assets	2,442	(453)	1,989
Financial assets – current	673	(25)	648
Cash and cash equivalents	1,851	(11)	1,840
Current assets	12,525	(562)	11,963
TOTAL ASSETS	76,755	8,652	85,407
LIABILITIES & EQUITY			
Shareholders' equity	35,590	5,471	41,061
Minority interests	359	103	462
Total equity	35,949	5,574	41,523
Long-term debt	8,638	16	8,654
Provisions and other non-current liabilities	5,768	1,161	6,929
Deferred tax liabilities	11,395	1,728	13,123
Non-current liabilities	25,801	2,905	28,706
Accounts payable and accrued expenses	2,765	(16)	2,749
Other current liabilities	4,852	189	5,041
Short-term debt and current portion of long-term debt	7,388	—	7,388
Current liabilities	15,005	173	15,178
TOTAL LIABILITIES & EQUITY	76,755	8,652	85,407

⁽¹⁾ Revisions to estimates of the fair value of the identifiable assets, liabilities and contingent liabilities of Group A (see Note D.1.2)

Balance sheet reconciliation at December 31, 2004

(€ million)	Elimination of treasury shares (1)	Fair value of financial instruments (2)	Discounting of long-term provisions (3)	Deferred taxes (4)	Share-based payment (5)	Actuarial losses on pension obligations (6)	Capitalization of acquired and internal R&D (7)	Capitalization of Group A R&D (8)	Amortization of Group A R&D (9)	Goodwill on acquisition of Group A (10)	Elimination of goodwill amortization (11)	Other adjustments (12)	BMS reclassification (13)	Total IFRS adjustments and reclassifications and revisions of estimates
ASSETS														
Property, plant and equipment	—	—	—	—	—	—	—	—	—	6	—	—	—	6
Goodwill	—	—	—	—	—	—	—	—	—	4,579	284	—	—	4,863
Intangible assets	—	—	—	—	—	—	52	4,748	(85)	(1,086)	—	—	—	3,629
Investments in associates	—	—	—	—	—	—	—	289	—	67	4	8	159	527
Financial assets-non-current	—	111	—	—	—	(50)	—	—	—	(31)	—	—	—	30
Deferred tax assets	—	(25)	—	(32)	—	61	(3)	—	—	158	—	—	—	159
Non-current assets	—	86	—	(32)	—	11	49	5,037	(85)	3,693	288	8	159	9,214
Inventories	—	—	—	—	—	—	—	—	—	(25)	—	(1)	—	(26)
Accounts receivable	—	(28)	—	—	—	—	—	—	—	2	—	(21)	—	(47)
Other current assets	—	(482)	—	—	—	—	—	—	—	119	—	(1)	(89)	(453)
Financial assets – current	(624)	573	—	—	—	—	—	—	—	27	—	(1)	—	(25)
Cash and cash equivalents	—	—	—	—	—	—	—	—	—	—	—	(11)	—	(11)
Current assets	(624)	63	—	—	—	—	—	—	—	123	—	(35)	(89)	(562)
TOTAL ASSETS	(624)	149	—	(32)	—	11	49	5,037	(85)	3,816	288	(27)	70	8,652
LIABILITIES & EQUITY														
Shareholder equity	(638)	125	3	7	—	(128)	34	5,060	(53)	770	288	3	—	5,471
Minority interests	—	—	—	—	—	—	—	—	—	34	—	(1)	70	103
Total equity	(638)	125	3	7	—	(128)	34	5,060	(53)	804	288	2	70	5,574
Long-term debt	—	16	—	—	—	—	—	—	—	—	—	—	—	16
Provisions & other non-current liabilities	—	—	(5)	—	—	139	—	—	—	1,027	—	—	—	1,161
Deferred tax liabilities	14	29	2	(405)	—	—	15	(23)	(32)	2,128	—	—	—	1,728
Non-current liabilities	14	45	(3)	(405)	—	139	15	(23)	(32)	3,155	—	—	—	2,905
Accounts payable and accrued expenses	—	8	—	—	—	—	—	—	—	—	—	(24)	—	(16)
Other current liabilities	—	(29)	—	366	—	—	—	—	—	(143)	—	(5)	—	189
Current liabilities	—	(21)	—	366	—	—	—	—	—	(143)	—	(29)	—	173
TOTAL LIABILITIES & EQUITY	(624)	149	—	(32)	—	11	49	5,037	(85)	3,816	288	(27)	70	8,652

IFRS transition adjustments increased **Shareholders' equity** by €5,471 million and **Minority interests** by €103 million at December 31, 2004.

- (1) The carrying amount of treasury shares (net of provisions for impairment), i.e. €624 million, was deducted from **Shareholders' equity**, along with the related increase of €14 million in **Deferred tax liabilities**.
- (2) Recognition of financial instruments at fair value impacted a number of balance sheet items. The overall net impact, after a deferred tax effect of €54 million, was to increase **Shareholders' equity** by €125 million.

Derivative instruments were reclassified in order to present the impact of their remeasurement on assets or on liabilities as appropriate.

The increase in the fair value of financial assets related to:

- Derivative instruments: €11 million in **Financial assets – non-current** related to a specific derivative (contingent payment arising on the disposal of a subsidiary), and €63 million for instruments classified in current assets related to currency and interest rate hedges.
- Available-for-sale financial assets, classified in **Financial assets – non-current**. The total adjustment of €100 million includes an €69 million increase in the fair value of an investment. The increase in the value of this investment as of December 31, 2004 reflects the rise in the stock market price of the shares relative to the price used in the preparation of the opening balance sheet as of August 20, 2004.

The €16 million increase in **Long-term debt** relates to the reclassification of the 1983 participating shares from other equity instruments to debt.

- (3) Discounting of long-term provisions resulted in a negative adjustment of €5 million to **Provisions and other non-current liabilities**, and a deferred tax liability of €2 million.
- (4) The deferred tax adjustment was mainly due to the recognition of deferred taxes on taxable temporary differences arising on investments in associates and joint ventures. This led to a €39 million decrease in **Deferred tax liabilities** and a €32 million decrease in **Deferred tax assets**. The other changes in **Deferred tax liabilities** consisted of reclassifications with **Other current liabilities** amounting to €366 million.
- (5) Recognition of share-based payment had no impact on shareholders' equity because the expense of €112 million (related to the fair value of stock option plans) charged to the income statement was taken against shareholders' equity.
- (6) At the transition date, the Group recognized all previously unrecognized actuarial gains and losses directly in **Shareholders' equity**. Consequently, the amortization of previous actuarial gains and losses was eliminated from the income statement in 2004. As at December 31, 2004, the impact on **Provisions and other non-current liabilities** was an increase of €139 million, while there was a reduction of €50 million in the receivable recorded in respect of overfunding of pension plans in **Financial assets – non-current**.
- (7) The effect of capitalizing milestone payments on external research and development projects, payments made to acquire generics files, and internal second-generation process development costs in **Intangible assets** amounted to €52 million (net of amortization) as at December 31, 2004. Virtually all the milestones capitalized relate to compounds under development, which means that the related intangible asset is not yet being amortized. Net of an €18 million tax effect, the impact on **Shareholders' equity** of applying IAS 38 to research and development is €34 million.
- (8) In accounting for the business combination with Group A under IFRS, the Group capitalized acquired in-process research and development that had been expensed under Previous GAAP. At December 31, 2004, capitalized in-process research and development in the balance sheet (including the effect of translation differences) amounted to €4,748 million in **Intangible assets** and €289 million in **Investments in associates**.
- (9) In 2004, the Group started to amortize the portion of in-process research and development acquired through the business combination with Group A that related to projects for which regulatory marketing approval had been obtained since the date of the combination (August 20, 2004). This amortization generated a reduction of €14 million in **Intangible assets**. In addition, termination of a research and development agreement contracted by the former Group A led to the recognition of an impairment loss of €71 million against the related in-process research and development.
- (10) The recalculation of goodwill under IFRS and a revision of certain aspects of the purchase price allocation led to an increase of €4,579 million in goodwill at December 31, 2004 (including the effect of translation differences but before elimination of amortization – see item 11 below). This increase in goodwill was matched mainly by tax effects and by the fair value of Group A stock option plans.

The difference between goodwill under Previous GAAP and goodwill under IFRS at the date of the combination with Group A (August 20, 2004) was as follows (€ million):

• Goodwill under Previous GAAP (1)	24,654
• Goodwill under IFRS	29,490
	<hr/>
• Increase in goodwill under IFRS (based on price at August 20, 2004)	4,836

- (1) Includes €715 million on the December 23, 2004 merger of Group A into the Group.

This increase breaks down into the following components (€ million):

• Deferred tax liability on acquired in-process R&D capitalized under IFRS	1,862
• Fair value of Group A stock option plans vested or exercisable at August 20, 2004	746
• Deferred taxes on taxable temporary differences, mainly related to investments in associates	305
• Impact of revised estimate of intangible assets (1)	1,229
• Increase in provisions for risks and for pension obligations (1)	916
• Revised estimate of investments and contracts relating to intangible rights (1)	(187)
• Deferred tax effect of revised estimates of assets and liabilities (1)	(662)
• Additional tax cost of distribution of acquired reserves	539
• Other items	88
	<hr/>
	4,836

⁽¹⁾ Following the review of the allocation of the Group A purchase price conducted in 2005 (within the 12-month revision period allowed under IFRS 3), the Group has revised the fair values of certain identifiable assets, liabilities and contingent liabilities, thereby also adjusting the amount of goodwill.

The adjustment to goodwill was mainly due to (i) higher provisions for environmental and tax risks, for litigation and for pension obligations (€916 million) identified as a result of further information and (ii) a revised estimate of the value of acquired rights to certain products previously marketed by the former Group A group (€1,229 million), plus the deferred tax effect of these items.

- (11) Under IFRS, the Group eliminated goodwill amortization, giving a positive impact of €288 million. Of this, €8 million related to goodwill arising prior to August 20, 2004 and €280 million to the combination with Group A (including €4 million related to associates and joint ventures of Group A).

(12) Other adjustments related to:

- The combined negative effect of all the adjustments described above on **Minority interests**, amounting to €1 million.
- The effect of the adoption of the equity method of accounting for joint ventures, previously consolidated by the proportionate method. Consolidated amounts relating to these entities were reclassified in the balance sheet to **Investments in associates**, increasing this item by €8 million (with no impact on shareholders' equity).

(13) For the alliance with BMS, the Group made the following reclassifications:

- The share of net assets attributable to BMS, relating to entities majority-owned by the Group, was reclassified under **Minority interests** (€70 million).
- The share of net assets attributable to the Group, relating to entities majority-owned by BMS, was reclassified under **Investments in associates** (€159 million).

F.2.2. Note on the reconciliation of the 2004 consolidated income statement

The consolidated income statement includes the results of Group A from August 20, 2004.

(€ million)	Year ended Dec. 31, 2004 Previous GAAP	IFRS reclassifications	IFRS transition adjustments	Year ended Dec. 31, 2004 IFRS
Net sales	15,043	(84)	(88)	14,871
Other revenues	—	856	6	862
Cost of sales	(3,753)	(689)	3	(4,439)
Gross profit	11,290	83	(79)	11,294
Research and development expenses	(7,455)	—	5,066	(2,389)
Selling and general expenses	(4,500)	(83)	(17)	(4,600)
Other current operating income	360	(182)	(2)	176
Other current operating expenses	—	—	—	—
Amortization of intangibles	—	(1,563)	(18)	(1,581)
Operating income – current	(305)	(1,745)	4,950	2,900
Restructuring costs	—	(608)	(71)	(679)
Impairment of property, plant & equipment and intangibles	—	—	—	—
Other operating income and expenses	—	206	(1)	205
Operating income	(305)	(2,147)	4,878	2,426
Amortization and impairment of intangibles *	(1,563)	1,563	—	—
Financial expenses	(230)	—	(9)	(239)
Financial income	255	(142)	11	124
Income before tax and associates	(1,843)	(726)	4,880	2,311
Exceptional items *	(402)	402	—	—
Income tax expense	(819)	220	120	(479)
Share of profit/loss of associates	(261)	361	309	409
Goodwill amortization *	(292)	—	292	—
Net income before minority interests	(3,617)	257	5,601	2,241
Minority interests	7	(257)	(5)	(255)
CONSOLIDATED NET INCOME	(3,610)	—	5,596	1,986

* This item is not included in the IFRS income statement presentation

Earnings per share attributable to the Group shareholders

- Basic earnings per share	(3.91) ⁽¹⁾	2.1 ⁽²⁾
- Diluted earnings per share	(3.91) ⁽¹⁾	2.1 ⁽³⁾

⁽¹⁾ 923,286,539 shares under Previous GAAP

⁽²⁾ 910,261,740 shares under IFRS

⁽³⁾ 914,778,793 shares under IFRS

F.2.2.1. IFRS reclassifications (year ended December 31, 2004)

(€ million)	Reclassification of amortization & impairment of intangibles (1)	Reclassification of exceptional items (2)	Reclassification of pharmaceutical industry levies (3)	Reclassification of royalty income (4)	BMS reclassification (5)	Reclassification of operating forex gains & losses (6)	Total IFRS reclassifications
Net sales	—	—	(84)	—	—	—	(84)
Other revenues	—	—	—	856	—	—	856
Cost of sales	—	—	167	(856)	—	—	(689)
Gross profit	—	—	83	—	—	—	83
Research and development expenses	—	—	—	—	—	—	—
Selling and general expenses	—	—	(83)	—	—	—	(83)
Other current operating income	—	—	—	—	(324)	142	(182)
Other current operating expenses	—	—	—	—	—	—	—
Amortization of intangibles	(1,563)	—	—	—	—	—	(1,563)
Operating income – current	(1,563)	—	—	—	(324)	142	(1,745)
Restructuring costs	—	(608)	—	—	—	—	(608)
Impairment of property, plant & equipment and intangibles	—	—	—	—	—	—	—
Other operating income and expenses	—	206	—	—	—	—	206
Operating income	(1,563)	(402)	—	—	(324)	142	(2,147)
Amortization and impairment of intangibles *	1,563	—	—	—	—	—	1,563
Financial expenses	—	—	—	—	—	—	—
Financial income	—	—	—	—	—	(142)	(142)
Income before tax and associates	—	(402)	—	—	(324)	—	(726)
Exceptional items *	—	402	—	—	—	—	402
Income tax expense	—	—	—	—	220	—	220
Share of profit/loss of associates	—	—	—	—	361	—	361
Goodwill amortization *	—	—	—	—	—	—	—
Net income before minority interests	—	—	—	—	257	—	257
Minority interests	—	—	—	—	(257)	—	(257)
Consolidated net income	—	—	—	—	—	—	—

* This item is not included in the IFRS income statement presentation

The Group made the following reclassifications in order to present its income statement in accordance with IFRS, with no impact on consolidated net income.

- (1) Amortization and impairment of intangible assets, recorded below **Operating income** under Previous GAAP, were reclassified to **Operating income – current**, reducing this item by €1,563 million.
- (2) Exceptional items, representing a net expense of €402 million under Previous GAAP, were reclassified to **Restructuring costs** (€608 million expense) and **Other operating income and expenses** (€206 million income).

The €206 million reclassified to **Other operating income and expenses** related mainly to the gain on the divestment of two products and the related assets.

- (3) Pharmaceutical industry levies that are in substance reductions in the consideration of the seller (i.e. rebates), previously recognized in **Cost of sales**, were reclassified as a reduction of **Net sales**. This treatment applies mainly to levies paid in Germany, Italy and Austria, and to some levies paid in France; the total amount was €84 million. All other levies, which are in substance taxes, were reclassified to **Selling and general expenses**, the amount involved being €83 million.
- (4) Royalty income under license agreements related to continuing operations, amounting to €856 million, was reclassified to **Other revenues**. This income was previously accounted for as a reduction in **Cost of sales**.
- (5) For the alliance with BMS, the Group made the following reclassifications:

- The share of net assets attributable to BMS relating to co-promotion in territories covered by entities majority-owned by the Group (€257 million) was reclassified to **Minority interests**. Given that BMS receives a share of pre-tax profits, there was no tax effect.

- The share of co-promotion profits attributable to the Group for territories covered by entities majority-owned by BMS was reclassified to **Share of profit/loss of associates** (€581 million, minus a tax effect of €220 million).

- (6) Realized and unrealized foreign exchange gains and losses on operating activities were reclassified to **Other current operating income** under IFRS. This reclassification had the effect of increasing **Operating income – current** by €142 million.

F.2.2.2. IFRS adjustments (year ended December 31, 2004)

(€ million)	Elimination of treasury shares (1)	Fair value of financial instruments (2)	Discounting of long-term provisions (3)	Deferred taxes (4)	Share-based payment (5)	Actuarial losses on pension obligations (6)	Capitalization of acquired and internal R&D (7)	Capitalization of Group A R&D (8)	Amortization of Group A R&D (9)	Goodwill on acquisition of Group A (10)	Elimination of goodwill amortization (11)	Other adjustments (12)	Total IFRS transition adjustments
Net sales	—	—	—	—	—	—	—	—	—	—	—	(88)	(88)
Other revenues	—	—	—	—	—	—	—	—	—	—	—	6	6
Cost of sales	—	—	—	—	(12)	3	—	—	—	—	—	12	3
Gross profit	—	—	—	—	(12)	3	—	—	—	—	—	(70)	(79)
Research and development	—	—	—	—	(18)	1	31	5,046	—	—	—	6	5,066
Selling and general expenses	—	—	—	—	(80)	7	—	—	—	—	—	56	(17)
Other current operating income	—	(2)	—	—	—	—	—	—	—	—	—	—	(2)
Other current operating expenses	—	—	—	—	—	—	—	—	—	—	—	—	—
Amortization of intangibles	—	—	—	—	—	—	(4)	—	(14)	—	—	—	(18)
Operating income – current	—	(2)	—	—	(110)	11	27	5,046	(14)	—	—	(8)	4,950
Restructuring costs	—	—	—	—	—	—	—	—	(71)	—	—	—	(71)
Impairment of property, plant & equipment and intangibles	—	—	—	—	—	—	—	—	—	—	—	—	—
Other operating income and	—	—	—	—	—	—	—	—	—	—	(1)	—	(1)
Operating income	—	(2)	—	—	(110)	11	27	5,046	(85)	—	(1)	(8)	4,878
Financial expenses	(4)	(4)	(1)	—	—	—	—	—	—	—	—	—	(9)
Financial income	—	11	—	—	—	—	—	—	—	—	—	—	11
Income before tax and associates	(4)	5	(1)	—	(110)	11	27	5,046	(85)	—	(1)	(8)	4,880
Income tax expense	1	(2)	—	52	—	(4)	(9)	23	32	23	—	4	120
Share of profit/loss of associates	—	—	—	—	(2)	—	—	301	—	—	5	5	309
Goodwill amortization	—	—	—	—	—	—	—	—	—	—	292	—	292
Net income before minority interests	(3)	3	(1)	52	(112)	7	18	5,370	(53)	23	296	1	5,601
Minority interests	—	—	—	—	—	—	—	—	—	—	—	(5)	(5)
Consolidated net income	(3)	3	(1)	52	(112)	7	18	5,370	(53)	23	296	(4)	5,596

* This item is not included in the IFRS income statement presentation

IFRS transition adjustments resulted in increases of €5,596 million in **Consolidated net income** and €5 million in **Minority interests**.

- The reversal of the provision for impairment of treasury shares was eliminated; the amount involved was €4 million, with a tax effect of €1 million.
- Recognition of derivative instruments at fair value led to a decrease of €2 million in **Other current operating income** and an increase of €4 million in **Financial expenses**, relating to currency and interest rate hedges. In addition, the recognition at fair value of a specific derivative (contingent payment arising on the disposal of a subsidiary) had a positive effect of €11 million on **Financial income**. After a €2 million tax effect, the recognition of financial instruments at fair value had a net effect of €3 million.
- The unwinding of discounting on long-term provisions to reflect the passage of time generated an adjustment of €1 million to **Financial expenses**.
- The deferred tax adjustment, related primarily to taxable temporary differences arising on investments in associates and joint ventures, generated an additional income tax expense of €52 million.
- Recognition of share-based payment generated an additional expense of €112 million in the income statement, representing the value of services received from employees in 2004 under stock option plans not yet vested.
- Because the Group recognized all previously unrecognized actuarial gains and losses directly in **Shareholders' equity** at the transition date, the net expense for the year related to past actuarial gains and losses (€11 million) was eliminated, along with the related tax effect (€4 million).
- The capitalization of milestone payments related to external research and development projects resulted in a decrease of €31 million in **Research and development expenses**. Amortization charged during the period against previously capitalized research and development expenses amounted to €4 million. After including the €9 million tax effect arising from these adjustments, the net positive effect of IAS 38 on **Research and development expenses** in the income statement was €18 million.

- (8) In accounting for the 2004 business combination with Group A under IFRS, the Group capitalized acquired in-process research and development that had been expensed under Previous GAAP. The positive effect of this adjustment on net income was recorded in **Research and development expenses** (€5,046 million) and in **Share of profit/loss from associates** (€301 million). The tax effect was €23 million.
- (9) In 2004, the Group started to amortize the portion of in-process research and development acquired through the business combination with Group A that related to projects for which regulatory marketing approval had been obtained since the date of the combination (August 20, 2004). This amortization generated a charge of €14 million, recognized in **Amortization of intangibles**. In addition, termination of a research and development agreement contracted by Group A led to the recognition of a €71 million charge in **Restructuring costs**. Net of the tax effect, these adjustments had an adverse impact of €53 million on the income statement.
- (10) Under Previous GAAP, the cost of the business combination with Group A included costs directly attributable to the combination net of tax. Under IFRS, these costs are recognized before tax. This divergence resulted in a positive tax adjustment under IFRS of €23 million.
- (11) Under IFRS, the Group eliminated goodwill amortization, giving a positive impact of €296 million on the income statement. Of this, €8 million related to goodwill arising prior to August 20, 2004 and €288 million to the combination with Group A (including €5 million related to associates and joint ventures of Group A).
- (12) Other adjustments related to:
- The combined effect of all the adjustments described above on **Minority interests**, amounting to €5 million.
 - The effect of the adoption of the equity method of accounting for joint ventures, previously consolidated by the proportionate method. Consolidated amounts relating to these entities were eliminated from the income statement and replaced by an entry that increases **Share of profit/loss from associates** by €5 million, with no impact on net income.

F.2.3. Note on the reconciliation of shareholders' equity at December 31, 2004

(€ million)	Share capital	Additional paid-in capital, reserves & retained earnings	Net income for the period	Treasury shares	Stock options	Items recognized directly in equity	Translation difference	Total Group	Minority interests	Total equity
Balance at December 31, 2004										
– Previous GAAP	2,823	42,928 ⁽¹⁾	(3,610)	(3,535)	—	—	(3,016)	35,590	359	35,949
Reclassification of cumulative translation differences at transition date	—	(404)	—	—	—	—	404	—	—	—
Elimination of treasury shares (IAS 32)										
• ex-Group shares	—	—	(3)	(619)	—	—	—	(622)	—	(622)
• ex-Group A shares	—	—	—	(16)	—	—	—	(16)	—	(16)
Fair value of financial instruments (IAS 39)										
• Available-for-sale financial assets: fair value remeasurement	—	—	—	—	—	79	—	79	—	79
• Derivative instruments: fair value remeasurement	—	2	3	—	—	58	(1)	62	—	62
• Reclassification of participating shares	—	(16) ⁽¹⁾	—	—	—	—	—	(16)	—	(16)
Discounting of long-term provisions (IAS 37)	—	4	(1)	—	—	—	—	3	—	3
Deferred taxes (IAS 12)	—	(44)	52	—	—	—	(1)	7	—	7
Share-based payment (IFRS 2)	—	(131)	(112)	—	243	—	—	—	—	—
Actuarial losses on pension obligations recognized in equity (IFRS 1)	—	(139)	7	—	—	—	4	(128)	—	(128)
Capitalization of research and development (IAS 38)	—	17	18	—	—	—	(1)	34	—	34
Business combination – acquisition of Group A										
• Capitalization of in-process research and development (IAS 38)	—	—	5,370	—	—	—	(274)	5,096	34	5,130
• Amortization & impairment of in-process research and development (IAS 38 and IAS 36)	—	—	(53)	—	—	—	—	(53)	—	(53)
• Additional goodwill arising on acquisition of Group A (IFRS 3)	—	—	23	—	—	—	(34)	(11)	—	(11)
• Elimination of goodwill amortization (IFRS 3)	—	—	296	—	—	—	(8)	288	—	288
• Fair value of Group A stock options allocated to purchase price (IFRS 2)	—	—	—	—	746	—	—	746	—	746
• Other IFRS adjustments related to the acquisition of Group A	—	—	—	—	—	2	—	2	—	2
Subtotal – acquisition of Group A	—	—	5,636	—	746	2	(316)	6,068	34	6,102
Other adjustments	—	4	(4)	—	—	—	—	0	(1)	(1)
BMS reclassification	—	—	—	—	—	—	—	—	70	70
Total IFRS transition adjustments and reclassifications	—	(707)	5,596	(635)	989	139	89	5,471	103	5,574
Balance at December 31, 2004										
– IFRS	2,823	42,221	1,986	(4,170)	989	139	(2,927)	41,061	462	41,523

⁽¹⁾ Including 1983 participating shares, €16 million