

OFFICEMAX INC  
Form 10-Q  
November 05, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 28, 2013

or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from            to

Commission File Number: 1-5057

**OFFICEMAX INCORPORATED**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of

**82-0100960**  
(I.R.S Employer

incorporation or organization)

Identification No.)

**263 Shuman Boulevard**

**Naperville, Illinois**  
(Address of principal executive offices)

**60563**  
(Zip Code)

**(630) 438-7800**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding as of November 1, 2013
Common Stock, \$2.50 par value	87,510,880

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****OfficeMax Incorporated and Subsidiaries****Consolidated Statements of Operations****(thousands, except per-share amounts)**

	<b>Three Months Ended</b>	
	<b>September 28, 2013</b>	<b>September 29, 2012</b>
	<b>(unaudited)</b>	
Sales	\$ 1,664,859	\$ 1,744,579
Cost of goods sold and occupancy costs	1,247,373	1,284,177
<b>Gross profit</b>	<b>417,486</b>	<b>460,402</b>
Operating expenses		
Operating, selling, and general and administrative expenses	389,127	415,511
Asset impairments and other operating expenses (income), net	(38,429)	11,432
<b>Operating income</b>	<b>66,788</b>	<b>33,459</b>
Interest expense	(16,643)	(16,873)
Interest income	10,687	11,003
Gain on extinguishment of non-recourse debt		670,766
Other income (expense), net	(97)	224
<b>Pre-tax income</b>	<b>60,735</b>	<b>698,579</b>
Income tax expense	(28,400)	(263,331)
<b>Net income attributable to OfficeMax and noncontrolling interest</b>	<b>32,335</b>	<b>435,248</b>
Joint venture results attributable to noncontrolling interest	(1,448)	(1,740)
<b>Net income attributable to OfficeMax</b>	<b>\$ 30,887</b>	<b>\$ 433,508</b>
Preferred dividends	(507)	(522)
<b>Net income available to OfficeMax common shareholders</b>	<b>\$ 30,380</b>	<b>\$ 432,986</b>
<b>Net income per common share</b>		
Basic	\$ 0.35	\$ 5.00
Diluted	\$ 0.34	\$ 4.92

See accompanying notes to quarterly consolidated financial statements

**Table of Contents****OfficeMax Incorporated and Subsidiaries****Consolidated Statements of Operations****(thousands, except per-share amounts)**

	Nine Months Ended	
	September 28, 2013	September 29, 2012
	(unaudited)	
Sales	\$ 4,964,637	\$ 5,219,890
Cost of goods sold and occupancy costs	3,700,854	3,867,198
Gross profit	1,263,783	1,352,692
Operating expenses		
Operating, selling, and general and administrative expenses	1,201,164	1,241,598
Asset impairments and other operating expenses (income), net	(105,197)	36,698
Operating income	167,816	74,396
Interest expense	(49,999)	(52,690)
Interest income	32,156	32,820
Gain on extinguishment of non-recourse debt		670,766
Other income (expense), net	(274)	449
Pre-tax income	149,699	725,741
Income tax expense	(68,661)	(272,251)
Net income attributable to OfficeMax and noncontrolling interest	81,038	453,490
Joint venture results attributable to noncontrolling interest	(2,843)	(3,345)
Net income attributable to OfficeMax	\$ 78,195	\$ 450,145
Preferred dividends	(1,514)	(1,581)
Net income available to OfficeMax common shareholders	\$ 76,681	\$ 448,564
Net income per common share		
Basic	\$ 0.88	\$ 5.18
Diluted	\$ 0.86	\$ 5.12

See accompanying notes to quarterly consolidated financial statements

**Table of Contents****OfficeMax Incorporated and Subsidiaries****Consolidated Statements of Comprehensive Income**

(thousands)

	Three Months Ended	
	September 28, 2013	September 29, 2012
	(unaudited)	
Net income attributable to OfficeMax and noncontrolling interest	\$ 32,335	\$ 435,248
Other comprehensive income:		
Cumulative foreign currency translation adjustment	9,837	17,888
Pension and postretirement liability adjustment, net of tax	2,644	2,179
Other comprehensive income	12,481	20,067
Comprehensive income attributable to OfficeMax and noncontrolling interest	\$ 44,816	\$ 455,315
Less:		
Joint venture results attributable to noncontrolling interest	\$ 1,448	\$ 1,740
Cumulative foreign currency translation adjustment attributable to noncontrolling interest	(557)	2,277
Joint venture comprehensive income attributable to noncontrolling interest	\$ 891	\$ 4,017
Comprehensive income attributable to OfficeMax	\$ 43,925	\$ 451,298

	Nine Months Ended	
	September 28, 2013	September 29, 2012
	(unaudited)	
Net income attributable to OfficeMax and noncontrolling interest	\$ 81,038	\$ 453,490
Other comprehensive income (loss):		
Cumulative foreign currency translation adjustment	(13,616)	17,464
Pension and postretirement liability adjustment, net of tax	11,249	6,313
Unrealized hedge loss, net of tax		(157)
Other comprehensive income (loss)	(2,367)	23,620
Comprehensive income attributable to OfficeMax and noncontrolling interest	\$ 78,671	\$ 477,110
Less:		
Joint venture results attributable to noncontrolling interest	\$ 2,843	\$ 3,345
Cumulative foreign currency translation adjustment attributable to noncontrolling interest	(867)	1,147
Joint venture comprehensive income attributable to noncontrolling interest	\$ 1,976	\$ 4,492
Comprehensive income attributable to OfficeMax	\$ 76,695	\$ 472,618

See accompanying notes to quarterly consolidated financial statements



**Table of Contents****OfficeMax Incorporated and Subsidiaries****Consolidated Balance Sheets**

(thousands)

	September 28, 2013 (unaudited)	December 29, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 504,201	\$ 495,056
Receivables, net	549,597	528,279
Inventories	697,724	812,454
Deferred income taxes and receivables	59,431	68,568
Other current assets	67,756	79,527
<b>Total current assets</b>	<b>1,878,709</b>	<b>1,983,884</b>
Property and equipment:		
Land and land improvements	38,920	40,404
Buildings and improvements	498,238	501,055
Machinery and equipment	789,722	797,378
<b>Total property and equipment</b>	<b>1,326,880</b>	<b>1,338,837</b>
Accumulated depreciation	(997,420)	(986,611)
<b>Net property and equipment</b>	<b>329,460</b>	<b>352,226</b>
Intangible assets, net	79,096	80,765
Investment in Boise Cascade Holdings, L.L.C.	40,896	175,000
Timber notes receivable	817,500	817,500
Deferred income taxes	50,240	108,759
Other non-current assets	232,785	266,181
<b>Total assets</b>	<b>\$ 3,428,686</b>	<b>\$ 3,784,315</b>

See accompanying notes to quarterly consolidated financial statements



**Table of Contents****OfficeMax Incorporated and Subsidiaries****Consolidated Balance Sheets**

(thousands, except share and per-share amounts)

	September 28, 2013 (unaudited)	December 29, 2012
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 573,838	\$ 699,636
Income tax payable	1,369	4,222
Accrued expenses and other current liabilities:		
Compensation and benefits	91,785	122,662
Other	258,721	219,889
Current portion of debt	6,620	10,232
<b>Total current liabilities</b>	<b>932,333</b>	<b>1,056,641</b>
Long-term debt, less current portion	225,736	225,962
Non-recourse debt	735,000	735,000
Other long-term items:		
Compensation and benefits obligations	342,569	365,568
Deferred gain on sale of assets	42,008	179,757
Other long-term liabilities	122,309	142,397
Noncontrolling interest in joint venture	62,062	44,617
OfficeMax shareholders equity:		
Preferred stock no par value; 10,000,000 shares authorized; Series D ESOP: \$.01 stated value; 583,222 and 608,693 shares outstanding	26,245	27,391
Common stock \$2.50 par value; 200,000,000 shares authorized; 87,433,875 and 86,883,521 shares outstanding	218,585	217,209
Additional paid-in capital	1,011,080	1,018,667
Accumulated deficit	(150,220)	(91,373)
Accumulated other comprehensive loss	(139,021)	(137,521)
<b>Total OfficeMax shareholders equity</b>	<b>966,669</b>	<b>1,034,373</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 3,428,686</b>	<b>\$ 3,784,315</b>

See accompanying notes to quarterly consolidated financial statements

**Table of Contents****OfficeMax Incorporated and Subsidiaries****Consolidated Statements of Cash Flows**

(thousands)

	Nine Months Ended	
	September 28, 2013	September 29, 2012
	(unaudited)	
Cash provided by operations:		
Net income attributable to OfficeMax and noncontrolling interest	\$ 81,038	\$ 453,490
Non-cash items in net income:		
Recognition of deferred gain from investment in Boise Cascade Holdings, L.L.C.	(137,523)	
Depreciation and amortization	55,930	55,704
Non-cash impairment charges		9,791
Pension and other postretirement benefits expense (income)	(285)	529
Non-cash gain on extinguishment of non-recourse debt.		(670,766)
Deferred income tax expense	62,977	250,337
Other	46,683	28,927
Changes in operating assets and liabilities:		
Receivables	(18,886)	28,360
Inventories	108,787	69,038
Accounts payable and accrued liabilities	(136,012)	(22,625)
Current and deferred income taxes	(3,013)	12,810
Collection of dividends receivable related to investment in Boise Cascade Holdings, L.L.C.	46,137	
Other	(20,609)	(57,765)
Cash provided by operations	85,224	157,830
Cash provided by (used for) investment:		
Expenditures for property and equipment	(65,285)	(48,173)
Return of investment in Boise Cascade Holdings, L.L.C.	134,104	
Proceeds from sales of assets	3,833	1,667
Other	(997)	
Cash provided by (used for) investment	71,655	(46,506)
Cash used for financing:		
Cash dividends paid:		
Common stock	(135,914)	(1,733)
Preferred stock	(1,020)	(1,059)
Borrowings (payments) of short-term debt, net	(2,077)	6,066
Borrowings of long-term debt	1,659	
Payments of long-term debt	(3,375)	(37,975)
Purchases of preferred stock	(914)	(187)
Proceeds from exercise of stock options	2,354	398
Payments related to other share-based compensation	(95)	(1,216)
Other	(4,660)	
Cash used for financing	(144,042)	(35,706)
Effect of exchange rates on cash and cash equivalents	(3,692)	3,293
Increase in cash and cash equivalents	9,145	78,911
Balance at beginning of the period	495,056	427,111

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Balance at end of the period	\$ 504,201	\$ 506,022
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See accompanying notes to quarterly consolidated financial statements

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited)****1. Basis of Presentation*****Nature of Operations***

OfficeMax Incorporated ( OfficeMax, the Company, we or our ) is a leader in both business-to-business and retail office products distribution. The Company provides office supplies and paper, print and document services, technology products and solutions, office furniture and facilities products to large, medium and small businesses, government offices and consumers. OfficeMax customers are served by approximately 27,000 associates through direct sales, catalogs, the Internet and a network of retail stores located throughout the United States, Canada, Australia, New Zealand and Mexico.

The accompanying quarterly consolidated financial statements include the accounts of OfficeMax and all majority-owned subsidiaries, except our 88%-owned subsidiary that formerly owned assets in Cuba that were confiscated by the Cuban government in the 1960s, which is accounted for as an investment due to various asset restrictions. We also consolidate the variable interest entities in which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation. These financial statements are for the thirteen-week and thirty-nine-week periods ended on September 28, 2013 (also referred to as the third quarter of 2013 or the three months ended September 28, 2013 and the first nine months of 2013 or the nine months ended September 28, 2013, respectively) and the thirteen-week and thirty-nine-week periods ended on September 29, 2012 (also referred to as the third quarter of 2012 or the three months ended September 29, 2012 and the first nine months of 2012 or the nine months ended September 29, 2012, respectively). The Company's fiscal year ends on the last Saturday in December with the exception of the Company's international businesses in the OfficeMax, Contract segment that, due primarily to statutory requirements, maintain fiscal years with December 31 year-ends and end their quarters on the last calendar day of the month. Grupo OfficeMax S. de R.L. de C.V. ( Grupo OfficeMax ), our majority-owned joint-venture in Mexico, reported one month in arrears in the first nine months of 2012. This practice was discontinued in the fourth quarter of 2012, resulting in fiscal year 2012 including 13 months for Grupo OfficeMax. This change in accounting policy did not have a material impact on the Company's financial statements. The fiscal year end for Grupo OfficeMax is the last Saturday in December beginning with the 2012 fiscal year.

The Company manages its business using three reportable segments: OfficeMax, Contract ( Contract segment or Contract ); OfficeMax, Retail ( Retail segment or Retail ); and Corporate and Other. Management reviews the performance of the Company based on these segments. We present information pertaining to our segments in Note 13, Segment Information.

The Company has prepared the quarterly consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ). Some information and note disclosures, which would normally be included in comprehensive annual financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted pursuant to those SEC rules and regulations. These quarterly consolidated financial statements should be read together with the consolidated financial statements and the accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 29, 2012.

The quarterly consolidated financial statements included herein have not been audited by an independent registered public accounting firm, but in the opinion of management, include all adjustments necessary to present fairly the results for the periods indicated. Except as disclosed within these Notes to Quarterly Consolidated Financial Statements (unaudited), the adjustments made were of a normal, recurring nature. Quarterly results are not necessarily indicative of results which may be expected for a full year.

***Recently Issued or Newly Adopted Accounting Standards***

In February 2013, the Financial Accounting Standards Board ( FASB ) issued guidance which expands disclosure requirements for other comprehensive income. The guidance requires the reporting of the effect of the

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

reclassification of items out of accumulated other comprehensive income on each affected net income line item. The guidance is effective for interim and annual periods beginning on or after December 15, 2012 and is to be applied prospectively. This guidance, which was adopted in the first quarter of 2013, affects the presentation of certain elements of the Company's financial statements, but these changes in presentation did not have a material impact on those financial statements.

In July 2013, the FASB issued guidance which affects the presentation of an unrecognized tax benefit in the Company's financial statements. The guidance is expected to reduce diversity in practice and better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The guidance is effective prospectively for interim and annual periods beginning after December 15, 2013, with early adoption and retrospective application permitted. The Company anticipates that adoption of this guidance may affect the presentation of certain elements of the Company's financial statements, but these changes in presentation will not have a material impact on our financial statements.

**2. Merger Agreement**

On February 20, 2013, OfficeMax entered into an Agreement and Plan of Merger (the "Merger Agreement") with Office Depot, Inc. ("Office Depot"), Dogwood Merger Sub Inc., a wholly owned direct subsidiary of Office Depot, Dogwood Merger Sub LLC, a wholly owned direct subsidiary of Office Depot, Mapleby Holdings Merger Corporation, a wholly owned direct subsidiary of OfficeMax ("New OfficeMax"), and Mapleby Merger Corporation, a wholly owned direct subsidiary of New OfficeMax, pursuant to which, through a series of transactions (the "Merger Transactions"), OfficeMax will become an indirect wholly-owned subsidiary of Office Depot and OfficeMax stockholders will become stockholders of Office Depot.

After giving effect to the Merger Transactions, each share of OfficeMax common stock issued and outstanding immediately prior to the effective time will be converted into the right to receive 2.69 shares of Office Depot common stock (the "exchange ratio"), together with cash in lieu of fractional shares, if any, and unpaid dividends and distributions, if any, pursuant to the Merger Agreement. The exchange ratio is fixed and will not be adjusted for changes in the market value of shares of Office Depot common stock or OfficeMax common stock. Because the exchange ratio was fixed at the time the Merger Agreement was executed and because the market value of Office Depot common stock and OfficeMax common stock will fluctuate during the pendency of the Merger Transactions, OfficeMax stockholders cannot be sure of the value of the shares of Office Depot common stock they will receive relative to the value of their shares of OfficeMax common stock.

Prior to the closing of the Merger Transactions (the "Closing"), OfficeMax will redeem each issued and outstanding share of OfficeMax Series D preferred stock for shares of OfficeMax common stock (excluding any shares of OfficeMax Series D preferred stock surrendered by the holder for conversion) in accordance with the Certificate of Designation for the OfficeMax Series D preferred stock. The shares of OfficeMax common stock issued upon such redemption or conversion will then be converted as a result of the Merger Transactions into the right to receive shares of Office Depot common stock in accordance with the exchange ratio, together with cash in lieu of fractional shares, if any, and unpaid dividends and distributions, if any, pursuant to the Merger Agreement.

After giving effect to the Merger Transactions, each outstanding OfficeMax stock option will be converted into an option to purchase, on the same terms and conditions as the OfficeMax stock option, a number of shares of Office Depot common stock that is equal to the number of shares of OfficeMax common stock subject to the OfficeMax stock option multiplied by the exchange ratio, at an exercise price per share of Office Depot common stock equal to the exercise price per share of OfficeMax common stock subject to the OfficeMax stock option divided by the exchange ratio. Each other OfficeMax stock-based award will be converted as a result of the

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

Merger Transactions into an award, on the same terms and conditions as the OfficeMax stock-based award, with respect to a number of shares of Office Depot common stock that is equal to the number of shares of OfficeMax common stock underlying such OfficeMax stock-based award multiplied by the exchange ratio, except that any then outstanding OfficeMax stock-based awards that vest based on the attainment of performance goals with a performance period that has not completed prior to the closing date will be converted into time-based awards that will vest at target levels at the originally scheduled vesting date, subject to any accelerated vesting upon a qualifying termination of employment in accordance with the terms of the 2003 OfficeMax Incentive and Performance Plan.

The Closing is subject to various conditions, including (i) approval of OfficeMax's stockholders; (ii) approval of Office Depot's stockholders; (iii) the expiration or earlier termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended; (iv) receipt of approvals or clearances required under the Canadian Competition Act and the Mexican Federal Law on Economic Competition; (v) there being no law or injunction, or agreement with a governmental authority under any antitrust laws, prohibiting consummation of the Merger Transactions; (vi) the effectiveness of a registration statement on Form S-4 under the Securities Act of 1933, as amended, with respect to shares of Office Depot common stock to be issued pursuant to the Merger Agreement; (vii) approval for listing such shares on the New York Stock Exchange; (viii) subject to certain exceptions, the accuracy of the representations and warranties of the parties; (ix) compliance by the parties in all material respects with their respective obligations and covenants; (x) the delivery of certain tax opinions from counsel to each of OfficeMax and Office Depot; and (xi) the absence of a material adverse effect. In addition, OfficeMax's obligation to consummate the Merger Transactions is subject to the completion of certain transactions by and with the holder of Office Depot's convertible preferred stock. Some of the above conditions, including the approvals of OfficeMax's and Office Depot's stockholders and the effectiveness of the registration statement, have already been satisfied.

The Merger Agreement contains certain termination rights in favor of OfficeMax and Office Depot, including if the Merger Transactions are not completed on or before December 31, 2013 (which date will be automatically extended to April 30, 2014 if certain conditions to Closing related to antitrust approvals have not been satisfied). The Merger Agreement also provides that, upon termination of the Merger Agreement under certain circumstances, OfficeMax may be required to pay Office Depot, or Office Depot may be required to pay OfficeMax, a termination fee of \$30 million.

We recorded \$30.5 million and \$49.1 million of expenses in the third quarter and first nine months of 2013, respectively, related to the proposed Merger Transactions which are included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations.

**3. Facility Closure Reserves**

We conduct regular reviews of our real estate portfolio to identify underperforming facilities, and close those facilities that are no longer strategically or economically beneficial. We record a liability for the cost associated with a facility closure at its estimated fair value in the period in which the liability is incurred, primarily the location's cease-use date. Upon closure, unrecoverable costs are included in facility closure reserves and include provisions for the present value of future lease obligations, less contractual or estimated sublease income. These facility closure charges are included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations. Accretion expense is recognized over the life of the required payments and is included in operating, selling, and general and administrative expenses in the Consolidated Statements of Operations.

During the first nine months of 2013, we recorded facility closure charges of \$4.1 million (all in the third quarter) in our Retail segment associated with the closing of six underperforming domestic stores prior to the end

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

of their lease terms. During the first nine months of 2012, we recorded facility closure charges of \$26.9 million in our Retail segment, of which \$1.6 million was recorded in the third quarter related to a change in the estimated lease obligation of a previously closed domestic store and \$25.3 million was recorded in the first quarter primarily related to the closure of 15 underperforming domestic stores prior to the end of their lease terms.

Facility closure reserve account activity during the first nine months of 2013 was as follows:

	<b>Total (thousands)</b>
Balance at December 29, 2012	\$ 74,643
Charges related to stores closed in 2013	4,121
Transfer of deferred rent and other balances	648
Cash payments	(21,151)
Accretion	1,884
 Balance at September 28, 2013	 \$ 60,145

Reserve balances were classified in the Consolidated Balance Sheets as follows:

	<b>September 28, 2013 (thousands)</b>
Accrued expenses and other current liabilities Other	\$ 19,386
Other long-term liabilities	40,759
 Total	 \$ 60,145

The facilities closure reserve consisted of the following:

	<b>September 28, 2013 (thousands)</b>
Estimated future lease obligations	\$ 102,353
Less: anticipated sublease income	(42,208)
 Total	 \$ 60,145

**4. Severance and Other Charges**

The first nine months of 2013 included severance charges recorded in the second quarter of \$4.5 million, related primarily to reorganizations in our Contract segment sales and supply chain operations in the U.S., New Zealand and Australia. These charges were included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations. There were no such charges in the first nine months 2012.

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As of September 28, 2013, \$3.7 million of the severance charges remain unpaid and are included in accrued expenses and other current liabilities in the Consolidated Balance Sheets.

### **5. Timber Notes/Non-Recourse Debt**

In October 2004, we sold our timberland assets in exchange for \$15 million in cash plus credit-enhanced timber installment notes in the amount of \$1,635 million (the Installment Notes ). The Installment Notes were issued by single-member limited liability companies formed by affiliates of Boise Cascade, L.L.C. (the Note Issuers ). The Installment Notes are 15-year non-amortizing obligations and were issued in two equal



**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

\$817.5 million tranches bearing interest at 5.11% and 4.98%, respectively. In order to support the issuance of the Installment Notes, the Note Issuers transferred a total of \$1,635 million in cash to Lehman Brothers Holdings Inc. ( Lehman ) and Wells Fargo & Company ( Wells ) (which at the time was Wachovia Corporation) (\$817.5 million to each of Lehman and Wells). Lehman and Wells issued collateral notes (the Collateral Notes ) to the Note Issuers. Concurrently with the issuance of the Installment and Collateral Notes, Lehman and Wells guaranteed the respective Installment Notes and the Note Issuers pledged the Collateral Notes as security for the performance of the Installment Note obligations.

In December 2004, we completed a securitization transaction in which the Company s interests in the Installment Notes and related guarantees were transferred to wholly-owned bankruptcy remote subsidiaries. The subsidiaries pledged the Installment Notes and related guarantees and issued securitized notes (the Securitization Notes ) in the amount of \$1,470 million (\$735 million through the structure supported by the Lehman guaranty and \$735 million through the structure supported by the Wells guaranty). As a result of these transactions, we received \$1,470 million in cash. Recourse on the Securitization Notes is limited to the proceeds of the applicable pledged Installment Notes and underlying Lehman or Wells guaranty, and therefore there is no recourse against OfficeMax. The Securitization Notes are 15-year non-amortizing, and were issued in two equal \$735 million tranches paying interest of 5.54% and 5.42%, respectively. The Securitization Notes are reported as non-recourse debt in the Company s Consolidated Balance Sheets.

On September 15, 2008, Lehman, the guarantor of half of the Installment Notes and the Securitization Notes, filed a petition in the United States Bankruptcy Court for the Southern District of New York seeking relief under chapter 11 of the United States Bankruptcy Code. Lehman s bankruptcy filing constituted an event of default under the \$817.5 million Installment Note guaranteed by Lehman (the Lehman Guaranteed Installment Note ). During the third quarter of 2012, we entered into an agreement that extinguished the Securitization Notes guaranteed by Lehman. Upon effectiveness of the agreement, the trustee for the Securitization Note holders released OfficeMax and its affiliates from the non-recourse liabilities following the transfer from OfficeMax to the trustee for the Securitization Note holders of the claims arising from the bankruptcy, the Lehman Guaranteed Installment Note and the related guaranty.

At the time of the sale of the timberlands in 2004, we generated a tax gain and recognized the related deferred tax liability. The timber installment notes structure allowed the Company to defer the resulting tax liability of \$529 million until 2020, the maturity date for the Installment Notes. In the third quarter of 2012, as a result of the agreement transferring our rights to the remaining receivable and the extinguishment of Securitization Notes guaranteed by Lehman, \$269 million of the deferred tax gain was recognized. At September 28, 2013, the remaining deferred tax gain of \$260 million is related to the Installment Notes guaranteed by Wells (the Wells Guaranteed Installment Notes ), and will be recognized upon maturity.

Through September 28, 2013, we have received all payments due under the Wells Guaranteed Installment Notes, which have consisted only of interest due on the notes, and have made all payments due on the related Securitization Notes guaranteed by Wells, again consisting only of interest due. As all amounts due on the Wells Guaranteed Installment Notes are current and we have no reason to believe that we will not be able to collect all amounts due according to the contractual terms of the Wells Guaranteed Installment Notes, the notes are reflected in our Consolidated Balance Sheets at their original principal amount of \$817.5 million. The Wells Guaranteed Installment Notes and related Securitization Notes are scheduled to mature in 2020 and 2019, respectively. The Securitization Notes have an initial term that is approximately three months shorter than the Wells Guaranteed Installment Notes.

**6. Net Income Per Common Share**

Basic net income per common share is calculated using net income available to holders of our common stock divided by the weighted average number of shares of common stock outstanding during the applicable

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

periods presented. Diluted net income per common share is similar to basic net income per common share except that the weighted average number of shares of common stock outstanding is increased to include, if their inclusion is dilutive, the number of additional shares of common stock that would have been outstanding assuming the issuance of all potentially dilutive shares, such as common stock to be issued upon the exercise of stock options, the vesting of restricted stock units, and the conversion of outstanding preferred stock. Net income per common share was determined by dividing net income, as adjusted, by weighted average shares outstanding as follows:

	Three Months Ended		Nine Months Ended	
	September 28, 2013 (thousands, except per- share amounts)	September 29, 2012 (thousands, except per- share amounts)	September 28, 2013 (thousands, except per- share amounts)	September 29, 2012 (thousands, except per- share amounts)
Net income available to OfficeMax common shareholders	\$ 30,380	\$ 432,986	\$ 76,681	\$ 448,564
Average shares basic	87,239	86,661	87,063	86,526
Net income available to OfficeMax common shareholders per common share:				
Basic	\$ 0.35	\$ 5.00	\$ 0.88	\$ 5.18

	Three Months Ended		Nine Months Ended	
	September 28, 2013 (thousands, except per- share amounts)	September 29, 2012 (thousands, except per- share amounts)	September 28, 2013 (thousands, except per- share amounts)	September 29, 2012 (thousands, except per- share amounts)
Net income available to OfficeMax common shareholders	\$ 30,380	\$ 432,986	\$ 76,681	\$ 448,564
Preferred dividends eliminated(a)		522		1,581
Diluted net income attributable to OfficeMax	30,380	433,508	76,681	450,145
Average shares basic	87,239	86,661	87,063	86,526
Restricted stock, stock options, preferred share conversion and other(a)(b)(c)	1,944	1,443	1,629	1,453
Average shares diluted	89,183	88,104	88,692	87,979
Diluted net income attributable to OfficeMax per common share:				
Diluted	\$ 0.34	\$ 4.92	\$ 0.86	\$ 5.12

- (a) The assumed conversion of outstanding preferred stock was anti-dilutive for the three and nine months ended September 28, 2013 and therefore no adjustment was required to determine diluted net income attributable to OfficeMax or average shares-diluted.
- (b) Options to purchase 2.4 million and 2.3 million shares of common stock were outstanding during the third quarter and first nine months of 2013, respectively, but were not included in the computation of diluted income per common share because the impact would have been anti-dilutive as such options exercise prices were higher than the average market price during those periods.
- (c) Options to purchase 4.2 million and 4.3 million shares of common stock were outstanding during the third quarter and first nine months of 2012, respectively, but were not included in the computation of diluted income per common share because the impact would have been anti-dilutive as such options exercise prices were higher than the average market price during those periods.

**7. Income Taxes**

The Company and its subsidiaries file income tax returns in the U.S. Federal jurisdiction, and multiple state and foreign jurisdictions. Years prior to 2010 are no longer subject to U.S. Federal income tax examination.



**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

During the first quarter of 2013, the Company received notice that all audit work related to U.S. federal income tax returns for the years 2006 through 2009 is complete and closed. The Company is no longer subject to state income tax examinations by tax authorities in its major state jurisdictions for years before 2003, and the Company is no longer subject to income tax examinations prior to 2005 for its major foreign jurisdictions.

As discussed in Note 5, Timber Notes/Non-Recourse Debt, at the time of the sale of the timberlands in 2004, we generated a tax gain and recognized the related deferred tax liability. The timber installment notes structure allowed the Company to defer the resulting tax liability until 2020, the maturity date for the Installment Notes. As the tax gain associated with the Lehman Guaranteed Installment Note was recognized in 2012, the remaining tax liability of \$260 million at September 28, 2013, is related to the Wells Guaranteed Installment Notes and will be recognized when the Wells Guaranteed Installment Notes are paid.

As of September 28, 2013, the Company had \$6.3 million of total unrecognized tax benefits, all of which would affect the Company's effective tax rate if recognized. Any future adjustments would result from the effective settlement of tax positions with various tax authorities. The Company does not anticipate any tax settlements to occur within the next twelve months. The reconciliation of the beginning and ending unrecognized tax benefits is as follows:

	<b>Amount</b> <b>(thousands)</b>
Unrecognized gross tax benefits balance at December 29, 2012	\$ 6,337
Increase related to prior year tax positions	1,111
Decrease related to prior year tax positions	(5)
Lapse of statute	(374)
Settlements	(765)
Unrecognized tax benefits balance at September 28, 2013	\$ 6,304

During the first nine months of 2013 and 2012, cash payments, net of refunds received, for income taxes were as follows:

	<b>2013</b>	<b>2012</b>
	<b>(thousands)</b>	
Cash tax payments, net	\$ 8,697	\$ 9,104

**8. Investment in Boise Cascade Holdings, L.L.C.**

In connection with the sale of the paper, forest products and timberland assets in 2004, we invested \$175 million in affiliates of Boise Cascade, L.L.C. Due to restructurings conducted by those affiliates, our investment is currently in Boise Cascade Holdings, L.L.C. ( BCH ), a building products company.

Our investment in BCH (the Boise Investment ) is accounted for under the cost method, as BCH does not maintain separate ownership accounts for its members' interests, and we do not have the ability to significantly influence the operating and financial policies of BCH. In exchange for investing in BCH, we received voting equity securities and non-voting equity securities.

A subsidiary of BCH, Boise Cascade, L.L.C., filed a registration statement with the SEC in November 2012 to register stock for an initial public offering (the Boise IPO ). Boise Cascade, L.L.C. completed the Boise IPO on February 11, 2013 and became Boise Cascade Company ( BCC ). In connection with the Boise IPO, BCH's equity interest in Boise Cascade, L.L.C. was automatically exchanged for 29.7 million shares of common stock of BCC. Subsequent to the Boise IPO, BCH executed a Fourth Amended and Restated Operating Agreement on February 26, 2013, pursuant to which BCH's then-existing Series B and Series C common units were exchanged



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**Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

for newly issued common units of Boise Cascade Holdings L.L.C., after which OfficeMax owns 5.9 million of the outstanding 29.7 million common units of BCH, representing a 20.01% ownership interest in BCH.

The non-voting securities of BCH were redeemed at the original investment amount of \$66 million in February 2013. Prior to the redemption, the non-voting securities accrued dividends daily at the rate of 8% per annum on the liquidation value plus the accumulated dividends. These dividends accumulated semiannually to the extent not paid in cash on the last day of June and December. The accumulated dividend receivable on the non-voting securities of \$46.1 million was also collected in February 2013. Our policy was to record the income associated with dividends on the non-voting securities as a reduction of operating, selling and general and administrative expenses in the Consolidated Statements of Operations. The income associated with the dividends on the non-voting securities ceased in the first quarter of 2013 as a result of the redemption of those securities. The Company recognized dividend income on the non-voting securities of \$1.0 million in 2013 (all in the first quarter) prior to the redemption, and \$2.2 million and \$6.3 million during the third quarter and first nine months of 2012, respectively.

The voting securities do not accrue dividends. However, in February and April 2013, we received distributions of \$17.3 million and \$4.4 million, respectively, related to the voting securities. Based on the accumulated earnings of BCH, these distributions were recorded as reductions in the carrying value of the Boise Investment.

In July 2013, we received a \$71.8 million distribution resulting from BCH's sale of 13.9 million common shares of BCC through a secondary public offering and a repurchase by BCC, from BCH, of 3.9 million shares BCC common stock. Following these transactions, BCH owns 15.8 million shares of BCC common stock. Based on the accumulated earnings of BCH, \$46.4 million of the \$71.8 million distribution was recorded as a reduction in the carrying value of the Boise Investment. The remaining \$25.4 million was recorded as income from dividends on the voting securities in asset impairments and other operating expenses (income), net in the Consolidated Statement of Operations. BCH's sale of BCC shares is expected to result in OfficeMax being allocated taxable income as a partner of the BCH entity. This allocation of taxable income, in turn, might result in cash taxes being due for the year when combined with OfficeMax's other taxable income or loss and credits.

The Boise Investment represented a continuing involvement in the operations of the business we sold in 2004. Therefore, \$179.8 million of gain realized from the sale was deferred. The redemption of the non-voting equity securities, as well as the portion of the distributions related to the voting equity securities that were recorded as reductions of the carrying value of Boise Investment, triggered recognition of pre-tax operating gains from partial recognition of the deferred gain, approximately \$47.7 million and \$137.7 million was recorded in the third quarter and nine months ended September 28, 2013, respectively. The gains were reported in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations for the third quarter and first nine months of 2013, respectively. The remaining \$42.0 million of deferred gain attributable to the voting equity securities will be recognized in earnings as the Company's investment is reduced.

As of September 28, 2013, based on the trading value of the publicly traded shares of BCC on that date, there was no indication of impairment of the Boise Investment.

**9. Debt**

***Credit Agreements***

On October 7, 2011, the Company entered into a Second Amended and Restated Loan and Security Agreement (the "Credit Agreement") with a group of banks. The Credit Agreement permits the Company to borrow up to a maximum of \$650 million, of which \$50 million is allocated to the Company's Canadian subsidiary and \$600 million is allocated to the Company and its other participating U.S. subsidiaries, in each case

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

subject to a borrowing base calculation that limits availability to a percentage of eligible trade and credit card receivables plus a percentage of the value of eligible inventory less certain reserves. The Credit Agreement may be increased (up to a maximum of \$850 million) at the Company's request and the approval of the lenders participating in the increase, or may be reduced from time to time at the Company's request, in each case according to the terms detailed in the Credit Agreement. Letters of credit, which may be issued under the Credit Agreement up to a maximum of \$250 million, reduce available borrowing capacity. At the end of the third quarter of 2013, the Company was in compliance with all covenants under the Credit Agreement. The Credit Agreement expires on October 7, 2016, although the Company may terminate it earlier upon prior notice. If the Credit Agreement has not been terminated or amended prior to completion of the Merger Transactions, the Merger Transactions will result in a default under the Credit Agreement.

Borrowings under the Credit Agreement are subject to interest at rates based on either the prime rate, the federal funds rate, LIBOR or the Canadian Dealer Offered Rate. An additional percentage, which varies depending on the level of average borrowing availability, is added to the applicable rates. Fees on letters of credit issued under the Credit Agreement are charged at rates between 1.25% and 2.25% depending on the type of letter of credit (i.e., stand-by or commercial) and the level of average borrowing availability. The Company is also charged an unused line fee of between 0.375% and 0.5% on the amount by which the maximum available credit exceeds the average daily outstanding borrowings and letters of credit. The fees on letters of credit were 1.75% and the unused line fee was 0.5% at the end of the third quarter of 2013.

Availability under the Credit Agreement at the end of the third quarter of 2013 was as follows:

	<b>Total (millions)</b>
Maximum aggregate available borrowing amount	\$ 590.4
Less: Stand-by letters of credit	(37.8)
<b>Amount available for borrowing</b>	<b>\$ 552.6</b>

There were no borrowings under the Credit Agreement during the first nine months of 2013.

**Other**

At the end of the third quarter of 2013, Grupo OfficeMax had total outstanding borrowings of \$6.1 million. This included \$1.0 million outstanding under a 60-month installment note due in the first quarter of 2014 and \$1.2 million outstanding under a 54-month installment note due in the third quarter of 2014. Payments on the installment loans are made monthly. The remaining \$3.9 million of borrowings is a simple revolving loan. Recourse on the Grupo OfficeMax loans is limited to Grupo OfficeMax. The installment loan maturing in the third quarter of 2014 is secured by certain owned property of Grupo OfficeMax. All other Grupo OfficeMax loan facilities are unsecured.

**Cash Paid for Interest**

Cash payments for interest, net of interest capitalized and including interest payments related to the Securitization Notes, were \$36.0 million and \$38.0 million for the first nine months of 2013 and 2012, respectively. Excluding interest payments related to the Securitization Notes, cash payments for interest, net of interest capitalized, were \$16.1 million and \$18.1 million for the first nine months of 2013 and 2012, respectively. Cash interest payments made on the Securitization Notes are completely offset by interest payments received on the Installment Notes.

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)****10. Financial Instruments, Derivatives and Hedging Activities***Fair Value of Financial Instruments*

The carrying amounts of cash and cash equivalents, trade accounts receivable, other assets (non-derivatives), short-term borrowings and trade accounts payable approximate fair value because of the short maturity of these instruments. The following table presents the carrying amounts and estimated fair values of the Company's other financial instruments at September 28, 2013 and December 29, 2012. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	September 28, 2013				Carrying Amount
	Level 1	Fair Value		Total	
		Level 2	Level 3		
		(thousands)			
Financial assets:					
Timber notes receivable	\$	\$ 938,255	\$	\$ 938,255	\$ 817,500
Boise Investment	\$	\$ 85,411	\$	\$ 85,411	\$ 40,896
Financial liabilities:					
Recourse debt	\$ 18,084	\$ 210,340	\$	\$ 228,424	\$ 232,356
Non-recourse debt	\$	\$ 857,001	\$	\$ 857,001	\$ 735,000

	December 29, 2012				Carrying Amount
	Level 1	Fair Value		Total	
		Level 2	Level 3		
		(thousands)			
Financial assets:					
Timber notes receivable	\$	\$ 986,365	\$	\$ 986,365	\$ 817,500
Financial liabilities:					
Recourse debt	\$	\$ 229,431	\$	\$ 229,431	\$ 236,194
Non-recourse debt	\$	\$ 903,912	\$	\$ 903,912	\$ 735,000

In establishing a fair value, there is a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The basis of the fair value measurement is categorized in three levels, in order of priority, described as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or financial instruments for which all significant inputs are observable either directly or indirectly.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable thus reflecting assumptions about the market participants.

The carrying amounts shown in the table are included in the Consolidated Balance Sheets under the indicated captions. The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

**Timber notes receivable:** Timber notes receivable as of September 28, 2013 consists solely of the Wells Guaranteed Installment Notes. The fair value of the Wells Guaranteed Installment Notes is determined as the present value of expected future cash flows discounted at the current interest rate for loans of similar terms with comparable credit risk (Level 2 inputs).





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**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

**Boise Investment:** The fair value of the Boise Investment is calculated as the sum of the market value of OfficeMax's indirect investment in BCC, the primary investment of BCH, plus OfficeMax's portion of any cash held by BCH as of the balance sheet date (together, Level 2 inputs). OfficeMax's indirect investment in BCC is calculated using the number of shares OfficeMax indirectly holds in BCC multiplied by the closing stock price of BCC as of the last trading day prior to the balance sheet date. Prior to the first quarter of 2013, it was not considered practicable to estimate the fair value of the Boise Investment. BCH and its subsidiaries were untraded companies without observable market inputs. However, as discussed in Note 8, Investment in Boise Cascade Holdings, L.L.C., BCC became a publicly traded company through the Boise IPO executed in the first quarter of 2013. As of September 28, 2013, the Boise Investment constitutes an indirect interest in BCC's publicly traded securities (NYSE: BCC). The availability of quoted market prices for the indirect investment made the estimate of fair value practicable beginning in the first quarter of 2013.

**Recourse debt:** The Company's debt instruments are not widely traded. Recourse debt for which there were trades on the last day of the period (the measurement date) was valued using the unadjusted quoted price from the last trade on the measurement date (Level 1 input). Recourse debt for which there were no transactions on the measurement date was valued based on quoted market prices near the measurement date when available or by discounting the future cash flows of each instrument using rates based on the most recently observable trade or using rates currently offered to the Company for similar debt instruments of comparable maturities (Level 2 inputs).

**Non-recourse debt:** Non-recourse debt as of September 28, 2013 consists solely of the Securitization Notes supported by Wells. The fair value of the Securitization Notes supported by Wells is estimated by discounting the future cash flows of the instrument at rates currently available to the Company for similar instruments of comparable maturities (Level 2 inputs).

During the first nine months of 2013, there were no significant changes to the techniques used to measure fair value except as noted above for the estimate of fair value of the Boise Investment. Other than routine borrowings and payments of recourse debt, there were no changes to the financial instruments for which fair value is being calculated. Any changes in the level of inputs for recourse debt is due to the existence or nonexistence of trades on the measurement date from which to obtain unadjusted quoted prices.

***Derivatives and Hedging Activities***

Changes in foreign currency exchange rates expose us to financial market risk. We occasionally use derivative financial instruments, such as forward exchange contracts, to manage our exposure associated with commercial transactions and certain liabilities that are denominated in a currency other than the currency of the operating unit entering into the underlying transaction. We do not enter into derivative instruments for any other purpose. We do not speculate using derivative instruments. The fair values of derivative financial instruments were not material at the end of the third quarter of 2013 or at 2012 fiscal year-end.

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)****11. Retirement and Benefit Plans****Components of Net Periodic Benefit Cost (Income)**

The following represents the components of net periodic benefit cost (income) for pension and other postretirement benefits which are recorded in operating, selling and general and administrative expense in the Consolidated Statements of Operations:

	Three Months Ended			
	Pension Benefits		Other Postretirement Benefits	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
	(thousands)			
Service cost	\$ 761	\$ 935	\$ 39	\$ 73
Interest cost	11,924	16,171	175	235
Expected return on plan assets	(17,375)	(20,773)		
Recognized actuarial loss	5,300	4,488	66	50
Amortization of prior service credits			(988)	(1,002)
Net periodic benefit cost (income)	\$ 610	\$ 821	\$ (708)	\$ (644)

	Nine Months Ended			
	Pension Benefits		Other Postretirement Benefits	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
	(thousands)			
Service cost	\$ 2,284	\$ 2,805	\$ 119	\$ 219
Interest cost	35,770	48,515	532	700
Expected return on plan assets	(52,125)	(62,320)		
Recognized actuarial loss	15,901	13,465	197	151
Amortization of prior service credits			(2,963)	(3,006)
Net periodic benefit cost (income)	\$ 1,830	\$ 2,465	\$ (2,115)	\$ (1,936)

**Cash Flows**

We expect to make \$3.0 million of contributions to the Company's pension plans in 2013, which we expect to fund with cash. As of September 28, 2013, \$2.3 million in cash has been contributed in 2013.

**12. Share-Based Compensation**

The Company sponsors several share-based compensation plans. The Company recognizes compensation expense from all share-based payment transactions with employees in the consolidated financial statements at fair value. Pre-tax compensation expense related to the Company's share-based plans was \$1.9 million and \$2.6 million for the third quarters of 2013 and 2012, respectively, and \$6.8 million and \$7.7 million for the first nine months of 2013 and 2012, respectively. Compensation expense is generally recognized on a straight-line basis over the vesting period of grants. The total income tax benefit recognized in the Consolidated Statements of Operations for share-based compensation arrangements was \$0.7 million and \$1.0 million for the third quarters of 2013 and 2012, respectively, and \$2.6 million and \$3.0 million for the

first nine months of 2013 and 2012, respectively.

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)*****Restricted Stock and Restricted Stock Units***

Restricted stock is restricted until it vests and cannot be sold by the recipient until its restrictions have lapsed. Each restricted stock unit ( RSU ) is convertible into one share of common stock after its restrictions have lapsed. The Company recognizes compensation expense related to these awards over the vesting periods based on the awards' grant date fair values. The Company calculates the grant date fair value of the RSU awards by multiplying the number of RSUs by the closing price of the Company's common stock on the grant date. If these awards contain performance criteria, the grant date fair value is set assuming performance at target, and management periodically reviews actual performance against the criteria and adjusts compensation expense accordingly. Pre-tax compensation expense and additional paid-in capital related to restricted stock and RSU awards was \$1.1 million and \$0.7 million for the third quarters of 2013 and 2012, respectively, and \$3.9 million and \$1.6 million for the first nine months of 2013 and 2012, respectively. The remaining compensation expense to be recognized related to outstanding restricted stock and RSU awards, net of estimated forfeitures, is approximately \$6.1 million and will be recognized through the first quarter of 2016.

As a result of a special non-recurring dividend of \$1.50 per share of common stock (the Special Dividend ), which is further described in Note 14, Shareholders' Equity and Noncontrolling Interest, outstanding RSU awards were equitably adjusted to maintain the awards' pre-dividend value, under existing anti-dilution provisions of the Company's share-based compensation plans. The adjustment resulted in an increase in the number of RSUs subject to previously existing RSU awards. The adjustment did not result in additional compensation expense because the fair value of the awards after adjustment was substantially equal to the fair value of the awards before the adjustment.

A summary of restricted stock and RSU activity for the first nine months of 2013 is presented in the following table:

	Shares	Weighted-Average Grant Date Fair Value Per Common Share
Unvested, December 29, 2012	1,317,756	\$ 10.70
Granted	1,416,052	11.71
Special Dividend adjustment	269,714	11.39
Vested	(26,536)	11.52
Forfeited	(785,737)	11.92
Unvested September 28, 2013	2,191,249	\$ 10.99

In the above table, granted RSUs include 216,730 shares of performance-based RSUs reserved for issuance in 2012 which were not considered granted or outstanding until 2013 when the associated performance measures were established.

Unvested restricted stock and RSUs are not included as shares outstanding in the calculation of basic earnings per share, but, except as described below, are included in the number of shares used to calculate diluted earnings per share as long as all applicable performance criteria are met, and their effect is dilutive. Unvested RSUs outstanding at September 28, 2013 in the above table do not include 215,965 shares of performance-based RSUs that were reserved for issuance in 2012 for which associated performance measures have not yet been established. Therefore, they are not considered granted or outstanding and have been excluded from the number of shares used to calculate diluted earnings per share.

There are 905,710 unvested performance based RSUs as of September 28, 2013 that would be converted into time based RSUs upon completion of the Merger Transactions, including the 215,965 shares of performance-based RSUs discussed above that have been reserved for issuance but are not considered granted in the above table. For more information related to the Merger Transactions, see Note 2, Merger Agreement.

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)****Stock Options**

The Company's stock options are issued with an exercise price equal to fair market value on the grant date and typically expire within seven years of the grant date. Stock options granted under the 2003 OfficeMax Incentive and Performance Plan generally vest over a three year period. Pre-tax compensation expense related to stock options was \$0.8 million and \$1.9 million for the third quarters of 2013 and 2012, respectively, and \$2.9 million and \$6.1 million for the first nine months of 2013 and 2012, respectively. The remaining compensation expense to be recognized related to outstanding stock options, net of estimated forfeitures, is approximately \$1.8 million and will be recognized through the fourth quarter of 2015.

As a result of the Special Dividend discussed in Note 14, Shareholders' Equity and Noncontrolling Interest, outstanding stock options were equitably adjusted to maintain the stock options' pre-dividend value, under existing anti-dilution provisions of the Company's share-based compensation plans. The adjustment resulted in an increase in the number of shares underlying each stock option and a decrease in the per-share exercise price of each stock option. The adjustment did not result in additional compensation expense because the fair value of the awards after the adjustment was substantially equal to the fair value of the awards before the adjustment.

A summary of stock option activity for the first nine months of 2013 is presented in the following table:

	Shares	Wtd. Avg. Exercise Price
Balance at December 29, 2012	5,212,738	\$ 10.57
Options granted	3,500	9.76
Special Dividend adjustment	635,142	9.56
Options exercised	(512,196)	4.60
Options forfeited and expired	(381,293)	11.50
Balance at September 28, 2013	4,957,891	\$ 9.76
Exercisable at September 28, 2013	2,789,496	
Weighted average fair value of options granted (Black-Scholes) during 2013	\$ 5.07	

The following table provides summarized information about stock options outstanding at September 28, 2013:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$2.21	12,645		\$ 2.21	12,645	\$ 2.21
\$3.50 \$9.00	2,589,353	5.0	5.09	1,008,158	4.97
\$11.00 \$15.00	1,251,698	3.9	13.96	1,032,563	13.76
\$16.00 \$22.00	1,104,195	4.1	16.03	736,130	16.03

At September 28, 2013, the aggregate intrinsic value was \$19.5 million for outstanding stock options and \$7.8 million for those stock options that were exercisable. The aggregate intrinsic value represents the total pre-tax intrinsic value (i.e. the difference between the Company's closing stock price on the last trading day of the third quarter of 2013 and the exercise price, multiplied by the number of in-the-money stock options at the end of the quarter).

During the first nine months of 2013, the Company granted stock options for 3,500 shares of our common stock and estimated the fair value of each stock option award on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

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risk-free interest rate of 0.63%, expected annual dividends of \$0.08 per share, expected life of 4.5 years and expected stock price volatility of 69.94%.

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**Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

The risk-free interest rate assumptions are based on the applicable U.S. Treasury Bill rates over the options' expected lives; the expected life assumptions are based on the time period stock options are expected to be outstanding based on historical experience; and the expected stock price volatility assumptions are based on the historical and implied volatility of the Company's common stock.

**13. Segment Information**

The Company manages its business using three reportable segments: Contract, Retail, and Corporate and Other. Management reviews the performance of the Company based on these segments.

Contract distributes a broad line of items for the office, including office supplies and paper, technology products and solutions, office furniture, print and document services and facilities products. Contract sells directly to large corporate and government offices, as well as to small and medium-sized offices and consumers in the United States, Canada, Australia and New Zealand. This segment markets and sells through field salespeople, outbound telesales, catalogs, the Internet and in some markets, including Canada, Australia and New Zealand, through office products stores. Substantially all products sold by Contract are purchased from third-party manufacturers or industry wholesalers. Contract purchases office papers for its businesses in the U.S., Canada, and Puerto Rico primarily from Boise White Paper, L.L.C., under a paper supply contract entered into on June 25, 2011.

Retail is a retail distributor of office supplies and paper, print and document services, technology products and solutions, office furniture and facilities products. In addition, this segment contracts with large national retail chains to supply office and school supplies to be sold in their stores. Retail office supply stores feature OfficeMax ImPress, an in-store module devoted to print-for-pay and related services. Retail has operations in the United States, Puerto Rico and the U.S. Virgin Islands. Retail also operates office products stores in Mexico through Grupo OfficeMax. Substantially all products sold by Retail are purchased from third-party manufacturers or industry wholesalers. Retail purchases office papers for its U.S. businesses primarily from Boise White Paper, L.L.C., under the paper supply contract described above.

Corporate and Other includes corporate support staff services and certain other legacy expenses as well as the related assets and liabilities. The income and expense related to certain assets and liabilities that are reported in the Corporate and Other segment have been allocated to the Contract and Retail segments.

Management evaluates the segments' performances using segment income (loss) which is based on operating income after eliminating the effect of certain legacy operating items such as income associated with our Boise Investment and certain other operating items such as store closure costs, costs related to the proposed Merger Transactions, impairment charges and severance charges, all of which are not indicative of our core operations.



**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

The following tables contain details of the Company's operations by segment:

	Sales	Segment income (loss)(1)	Asset impairment, and other operating income (expenses), net (thousands)	Operating income
<b>Three months ended September 28, 2013</b>				
Contract	\$ 841,866	\$ 8,819	\$	\$ 8,819
Retail	822,993	26,223	(4,121)	22,102
Corporate and Other		(6,683)	42,550	35,867
<b>Total</b>	<b>\$ 1,664,859</b>	<b>\$ 28,359</b>	<b>\$ 38,429</b>	<b>\$ 66,788</b>

<b>Three months ended September 29, 2012</b>				
Contract	\$ 880,898	\$ 26,485	\$	\$ 26,485
Retail	863,681	27,733	(11,432)	16,301
Corporate and Other		(11,496)	2,169	(9,327)
<b>Total</b>	<b>\$ 1,744,579</b>	<b>\$ 42,722</b>	<b>\$ (9,263)</b>	<b>\$ 33,459</b>

	Sales	Segment income (loss)(1)	Asset impairment, and other operating income (expenses), net (thousands)	Operating income
<b>Nine months ended September 28, 2013</b>				
Contract	\$ 2,612,819	\$ 41,304	\$ (4,311)	\$ 36,993
Retail	2,351,818	44,389	(4,165)	40,224
Corporate and Other		(24,121)	114,720	90,599
<b>Total</b>	<b>\$ 4,964,637</b>	<b>\$ 61,572</b>	<b>\$ 106,244</b>	<b>\$ 167,816</b>

<b>Nine months ended September 29, 2012</b>				
Contract	\$ 2,720,320	\$ 79,276	\$	\$ 79,276
Retail	2,499,570	53,400	(36,698)	16,702
Corporate and Other		(27,889)	6,307	(21,582)
<b>Total</b>	<b>\$ 5,219,890</b>	<b>\$ 104,787</b>	<b>\$ (30,391)</b>	<b>\$ 74,396</b>

(1) Beginning in 2013, segment income (loss) for all periods presented excludes dividend income from our Boise Investment due to the redemption of the non-voting securities in the first quarter of 2013 which totaled \$1.0 million for the first nine months of 2013 (all in the

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first quarter) and \$2.2 million and \$6.3 million during the third quarter and first nine months of 2012, respectively, and were reported in operating, selling and general and administrative expenses in the Consolidated Statements of Operations. Interest expense, interest income, gain on extinguishment of non-recourse debt and other income, net are not recorded by segments.

**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)****14. Shareholders' Equity and Noncontrolling Interest**

The following table reflects changes in shareholders' equity and noncontrolling interest for the first nine months of 2013.

	Shareholders Equity	Noncontrolling Interest
	(thousands)	
Balance at December 29, 2012	\$ 1,034,373	\$ 44,617
Comprehensive income:		
Net income attributable to OfficeMax and noncontrolling interest	78,195	2,843
Other comprehensive income:		
Foreign currency translation adjustments	(12,749)	(867)
Amortization of unrecognized retirement and benefit costs, net of tax	11,249	
Comprehensive income attributable to OfficeMax and noncontrolling interest	76,695	1,976
Common stock dividends	(135,040)	
Preferred stock dividends	(2,009)	
Stock-based compensation activity	9,058	
Non-controlling interest fair value adjustment	(15,493)	15,493
Other	(915)	(24)
Balance at September 28, 2013	\$ 966,669	\$ 62,062

**Special Dividend**

On May 6, 2013, the Company declared a special non-recurring dividend of \$1.50 per share of common stock totaling \$131.5 million to shareholders of record as of the close of business on June 12, 2013, of which \$130.7 million was paid in the third quarter of 2013. As a result of the Special Dividend, outstanding stock options and RSUs were equitably adjusted to maintain the awards' pre-dividend value under existing anti-dilution provisions of the Company's share-based compensation plans. See Note 12, Share-Based Compensation, for further information.

**Preferred Stock**

At September 28, 2013, 583,222 shares of 7.375% Series D ESOP convertible preferred stock were outstanding, compared with 608,693 shares outstanding at December 29, 2012. The Series D ESOP convertible preferred stock is shown in the Consolidated Balance Sheets at its liquidation preference of \$45 per share. All shares outstanding have been allocated to participants in the plan. Each ESOP preferred share is entitled to one vote, bears an annual cumulative dividend of \$3.31875 per share and is convertible at any time by the trustee into common stock using a conversion ratio established in accordance with the Certificate of Designation for the OfficeMax Series D preferred stock (Certificate of Designation), which was 0.9312 shares of common stock per share of preferred stock as of September 28, 2013. Upon redemption, ESOP participants receive \$45 of cash or common stock and cash, at the Company's election, for each ESOP preferred share, as the ESOP preferred shares may not be redeemed for less than the liquidation preference.

Prior to the closing of the Merger Transactions (the Closing), OfficeMax will redeem each issued and outstanding share of OfficeMax Series D preferred stock for shares of OfficeMax common stock (excluding any shares of OfficeMax Series D preferred stock surrendered by the holder for conversion) in accordance with the Certificate of Designation for the OfficeMax Series D preferred stock. The shares of OfficeMax common stock issued upon such redemption or conversion will then be converted as a result of the Merger Transactions into the right to receive shares of Office Depot common stock in accordance with the exchange ratio, together with cash in lieu of fractional shares, if any, and unpaid dividends and distributions, if any, pursuant to the Merger Agreement.



**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)****Changes in Accumulated Other Comprehensive Income (Loss)**

Changes in accumulated other comprehensive income (loss) by component includes the following for the first nine months of 2013:

	<b>Pension and Postretirement Liability Adjustment</b>	<b>Foreign Currency Translation Adjustment (thousands)</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>
Balance at December 29, 2012	\$ (288,450)	\$ 150,929	\$ (137,521)
Other comprehensive income (loss) before reclassifications	4,335	(12,749)	(8,414)
Amounts reclassified from accumulated other comprehensive income (loss):			
Amortization of unrecognized retirement and benefit costs	13,135		13,135
Current period other comprehensive income (loss)	17,470	(12,749)	4,721
Income taxes	(6,221)		(6,221)
Net current period other comprehensive income (loss)	11,249	(12,749)	(1,500)
Balance at September 28, 2013	\$ (277,201)	\$ 138,180	\$ (139,021)

All amounts reclassified out of accumulated other comprehensive income (loss) were recorded in operating, selling, and general and administrative expenses in the Consolidated Statements of Operations.

**15. Commitments and Guarantees****Commitments**

In accordance with an amended and restated joint venture agreement, the minority owner of Grupo OfficeMax, our joint-venture in Mexico, can elect to require OfficeMax to purchase the minority owner's 49% interest in the joint venture if certain earnings targets are achieved. Earnings targets are calculated quarterly on a rolling four-quarter basis. Accordingly, the targets may be achieved in one quarter but not in the next. If the earnings targets are achieved and the minority owner elects to require OfficeMax to purchase the minority owner's interest, the purchase price is based on the joint venture's earnings and the current market multiples of similar companies. At the end of the third quarter of 2013, Grupo OfficeMax met the earnings targets and the estimated purchase price of the minority owner's interest was \$61.1 million. This represents an increase in the estimated purchase price from the prior year which is attributable to higher market multiples for similar companies as of the measurement date. As the estimated purchase price was greater than the carrying value of the noncontrolling interest as of the end of the year, the Company recorded an adjustment to state the noncontrolling interest at the estimated purchase price, and, as the estimated purchase price approximates fair value, the offset was recorded to additional paid-in capital.

**16. Legal Proceedings and Contingencies**

As previously disclosed, eight putative class action lawsuits challenging the Merger Transactions were filed on behalf of a putative class consisting of OfficeMax stockholders.

Six lawsuits were filed in the Circuit Court of the Eighteenth Judicial Circuit of DuPage County, Illinois (the State Court): (i) Venkata S. Donepudi v. OfficeMax Incorporated, et al. (Case Number 2013L000188), filed on February 25, 2013; (ii) Beth Koenke v. OfficeMax Incorporated, et al. (Case Number 2013CH000776), filed on February 28, 2013; (iii) Marc Schmidt v. Saligram, et al. (Case Number 2013MR000411), filed on



**Table of Contents****Notes to Quarterly Consolidated Financial Statements (unaudited) (Continued)**

March 13, 2013; (iv) The Feivel & Helene Gottlieb Defined Benefit Pension Plan v. OfficeMax Incorporated, et al. (Case Number 2013L000246), filed on March 14, 2013; (v) Norman Klumpp v. Bryant, et al. (Case Number 2013CH1107), filed on March 28, 2013; and (vi) J. David Lewis v. OfficeMax Incorporated, et al. (Case Number 2013CH001123), filed on March 29, 2013. The above-referenced actions have been consolidated in Venkata S. Donepudi v. OfficeMax Incorporated, et al. (Case Number 2013L000188) (the State Action). A consolidated amended class action complaint was filed in the State Action on April 25, 2013.

Two lawsuits were filed in the United States District Court for the Northern District of Illinois, Eastern Division: (i) Eric Hollander v. OfficeMax Incorporated, et al. (Case Number 1:13-cv-03330), filed on May 2, 2013; and (ii) Thomas and Beverly DeFabio v. OfficeMax Incorporated, et al. (Case Number 1:13-cv-03385), filed on May 6, 2013 (the Federal Actions).

The State Action and the Federal Actions named OfficeMax, Office Depot and the directors of OfficeMax, among others, as defendants. Each of the lawsuits was brought by a purported holder or holders of OfficeMax common stock, both individually and on behalf of a putative class of OfficeMax stockholders. The lawsuits generally alleged, among other things, that the directors of OfficeMax breached their fiduciary duties to OfficeMax stockholders by agreeing to a transaction with inadequate and unfair consideration and pursuant to an inadequate and unfair process. The lawsuits further allege that OfficeMax and Office Depot, among others, aided and abetted the OfficeMax directors in the breach of their fiduciary duties. In addition, the lawsuits alleged that the disclosure in the definitive joint proxy statement/prospectus of OfficeMax and Office Depot filed with the SEC on June 10, 2013 was inadequate.

OfficeMax believes that these lawsuits are without merit and that no further disclosure was required to supplement the joint proxy statement/prospectus under applicable laws; however, to eliminate the burden, expense and uncertainties inherent in such litigation, on June 25, 2013, the defendants entered into a Memorandum of Understanding (the Memorandum of Understanding) regarding the settlement of the State Action and the Federal Actions. The Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release all claims which were or could have been asserted in the State Action and the Federal Actions. In consideration for such settlement and release, the parties to the State Action and the Federal Actions agreed that OfficeMax and Office Depot would make certain supplemental disclosures to the joint proxy statement/prospectus, which OfficeMax made in a Current Report on Form 8-K filed with the SEC on June 27, 2013. The Memorandum of Understanding contemplates that the parties will attempt in good faith to agree promptly upon a stipulation of settlement to be submitted to the State Court for approval at the earliest practicable time. The stipulation of settlement will be subject to customary conditions, including approval by the State Court, which will consider the fairness, reasonableness and adequacy of such settlement. The stipulation of settlement will provide that OfficeMax (or its successors in interest) will pay, on behalf of all defendants, the plaintiffs' attorneys' fees and expenses, subject to approval by the State Court, in the amount of \$0.7 million, following dismissal of both the State Action and the Federal Actions with prejudice. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the State Court will approve the settlement even if the parties were to enter into such stipulation. In such event, or if the transactions contemplated by the Merger Agreement are not consummated for any reason, the proposed settlement will be null and void and of no force and effect.

**17. Subsequent Events**

On November 1, 2013, the Federal Trade Commission cleared the proposed merger of OfficeMax and Office Depot. The proposed merger is expected to close on November 5, 2013.

On November 4, 2013, as a condition of the proposed merger, all of the shares of Series D ESOP convertible preferred stock were redeemed at a price of \$45 per share, plus all accrued and unpaid dividends thereon to the redemption date, paid in shares of OfficeMax common stock.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion contains statements about our future financial performance. These statements are only predictions. Our actual results may differ materially from these predictions. In evaluating these statements, you should review Item 1A. Risk Factors in our Annual Report on Form 10-K, for the year ended December 29, 2012, including Cautionary and Forward-Looking Statements.

*Overall Summary*

Sales for the third quarter of 2013 decreased 4.6% year-over-year to \$1,664.9 million, while sales for the first nine months of 2013 decreased 4.9% year-over-year to \$4,964.6 million. After adjusting for the changes in foreign currency exchange rates, the impact of stores opened and closed in 2013 and 2012, and the difference in business days at the international Contract businesses, sales for the third quarter of 2013 decreased 3.4% year-over-year, and sales for the first nine months of 2013 decreased 3.9% year-over-year. Gross profit margin decreased 1.3% of sales (130 basis points) to 25.1% of sales in the third quarter of 2013 and 0.4% of sales (40 basis points) to 25.5% of sales in the first nine months of 2013, compared to the same periods of 2012 due to lower customer margins in Contract and the deleveraging impact of lower sales on occupancy and delivery expense. Compared to the same periods of 2012, operating, selling and general and administrative expenses declined during the third quarter and first nine months of 2013 and declined as a percentage of sales for the third quarter of 2013, however increased as a percentage of sales for the first nine months of 2013. Operating, selling and general and administrative expenses were impacted to varying degrees for the third quarter and first nine months of 2013 by reduced incentive compensation expense (lower by \$3.8 million and \$21.8 million for the third quarter and first nine months of 2013, respectively), lower payroll and benefit costs, net favorable sales and property tax and legal settlements and lower advertising expenses, offset by increased spending and depreciation associated with our growth and profitability initiatives. We reported operating income of \$66.8 million in the third quarter of 2013, compared to \$33.5 million for the third quarter of 2012. For the first nine months of 2013, we reported operating income of \$167.8 million compared to \$74.4 million for the first nine months of 2012. As noted in the discussion and analysis that follows, our operating results were impacted by significant non-core items in some periods consisting of income associated with our investment in Boise Cascade Holdings, L.L.C. (Boise Investment), charges for closed stores, costs related to our proposed merger with Office Depot, Inc. (Office Depot), asset impairment charges in 2012 and severance charges as described below. If we eliminate these items from the applicable periods, our adjusted operating income was \$28.4 million and \$61.6 million for the third quarter and first nine months of 2013, respectively, and \$42.7 million and \$104.8 million for the third quarter and first nine months of 2012, respectively.

The reported net income available to OfficeMax common shareholders was \$30.4 million, or \$0.34 per diluted share, in the third quarter of 2013 compared to \$433.0 million, or \$4.92 per diluted share, in the third quarter of 2012. The reported net income available to OfficeMax common shareholders was \$76.7 million, or \$0.86 per diluted share, in the first nine months of 2013, compared to \$448.6 million, or \$5.12 per diluted share, in the first nine months of 2012. If we eliminate the impact of the significant non-core items recorded in operating income, discussed above, as well as the 2012 gain related to an agreement that legally extinguished our non-recourse debt guaranteed by Lehman Brothers Holding, Inc. (Lehman) from the applicable periods, our adjusted net income available to OfficeMax common shareholders was \$13.6 million, or \$0.15 per diluted share, and \$25.5 million, or \$0.29 per diluted share, for the third quarter and first nine months of 2013, respectively, and \$22.2 million, or \$0.25 per diluted share, and \$50.7 million, or \$0.58 per diluted share, for the third quarter and first nine months of 2012, respectively.

On February 20, 2013, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Office Depot, Inc. and certain other parties. In accordance with the Merger Agreement, and pursuant to a series of transactions contemplated by the Merger Agreement (together, the Merger), OfficeMax will become an indirect wholly-owned subsidiary of Office Depot, Inc. and each share of OfficeMax Incorporated common stock issued and outstanding immediately prior to the effective time of the Merger, other



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than shares to be cancelled pursuant to the terms of the Merger Agreement, will be converted into the right to receive 2.69 shares (the Exchange Ratio ) of Office Depot, Inc. common stock, together with cash in lieu of fractional shares, if any, and unpaid dividends and distributions, if any. The Merger Agreement permits OfficeMax to make a distribution to its stockholders of \$1.50 per share of OfficeMax common stock, which distribution will not result in any adjustment to the Exchange Ratio. On May 6, 2013, we declared a special non-recurring dividend (the Special Dividend ) of \$1.50 per share of common stock, totaling \$131.5 million to shareholders of record as of the close of business on June 12, 2013, which was substantially paid to shareholders in the third quarter of 2013.

The completion of the proposed merger is subject to various customary closing conditions, including among others receipt of regulatory approvals.

The Merger Agreement contains certain termination rights for both parties, and further provides for the payment of fees and expenses upon termination under specified circumstances. The proposed merger is expected to close on November 5, 2013.

**Results of Operations, Consolidated**

(\$ in thousands)

	Three months ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Sales	\$ 1,664,859	\$ 1,744,579	\$ 4,964,637	\$ 5,219,890
Gross profit	417,486	460,402	1,263,783	1,352,692
Operating, selling and general and administrative expenses	389,127	415,511	1,201,164	1,241,598
Asset impairments and other operating expenses (income), net	(38,429)	11,432	(105,197)	36,698
Total operating expenses	350,698	426,943	1,095,967	1,278,296
Operating income	\$ 66,788	\$ 33,459	\$ 167,816	\$ 74,396
Net income available to OfficeMax common shareholders	\$ 30,380	\$ 432,986	\$ 76,681	\$ 448,564
Gross profit margin	25.1%	26.4%	25.5%	25.9%
Operating, selling and general and administrative expenses				
Percentage of sales	23.4%	23.8%	24.2%	23.8%

In addition to assessing our operating performance as reported under U.S. generally accepted accounting principles ( GAAP ), we evaluate our results of operations before non-operating legacy items, such as the 2012 gain related to an agreement that legally extinguished our non-recourse debt guaranteed by Lehman, and certain legacy operating items such as income associated with our Boise Investment and certain other operating items such as store closure costs, costs related to our proposed Merger with Office Depot, asset impairments and severance charges, all of which are not indicative of our core operations. We believe our presentation of financial measures before, or excluding, these items, which are non-GAAP measures, enhances our investors' overall understanding of our operational performance and provides useful information to both investors and management to evaluate the ongoing operations and prospects of OfficeMax by providing better comparisons. Whenever we use non-GAAP financial measures, we designate these measures as adjusted and provide a reconciliation of the non-GAAP financial measures to the most closely applicable GAAP financial measure. Investors are encouraged to review the related GAAP financial measures and the reconciliation of these non-GAAP financial measures to their most directly comparable GAAP financial measure.

Although we believe the non-GAAP financial measures enhance an investor's understanding of our performance, our management does not itself, nor does it suggest that investors should, consider such non-GAAP

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financial measures in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. The non-GAAP financial measures we use may not be consistent with the presentation of similar companies in our industry. However, we present such non-GAAP financial measures in reporting our financial results to provide investors with an additional tool to evaluate our operating results in a manner that focuses on what we believe to be our ongoing business operations.

In the following tables, we reconcile our non-GAAP financial measures to our reported GAAP financial results. (Totals in the tables may not sum down due to rounding.)

	Non-GAAP Reconciliation Sales					
	Three Months Ended			Nine Months Ended		
	September 28, 2013	September 29, 2012 (thousands)	Percent Change	September 28, 2013	September 29, 2012 (thousands)	Percent Change
Sales as reported	\$ 1,664,859	\$ 1,744,579	(4.6)%	\$ 4,964,637	\$ 5,219,890	(4.9)%
Adjustment for unfavorable impact of change in foreign exchange rates(a)	11,453			6,034		
Adjustment for the impact of closed and opened stores and the difference in business days from year-to-year for businesses reporting on a calendar basis(b)	(10,241)	(20,659)		(27,201)	(73,280)	
Sales adjusted for impact of change in foreign exchange rates, closed and opened stores and change in number of business days	\$ 1,666,071	\$ 1,723,920	(3.4)%	\$ 4,943,470	\$ 5,146,610	(3.9)%

(a) Computed by assuming constant currency exchange rates between periods.

(b) Computed by reducing current year and prior year sales for stores opened or closed in the current or prior year and by adjusting prior year sales to reflect the same number of business days in the current year.

	Non-GAAP Reconciliations			Current Year Operating Results		
	Three Months Ended			Nine Months Ended		
	September 28, 2013	September 28, 2013	September 28, 2013	September 28, 2013	September 28, 2013	September 28, 2013
	Operating income	Net income available to OfficeMax common shareholders	Diluted income per common share	Operating income	Net income available to OfficeMax common shareholders	Diluted income per common share
	(thousands, except per-share amounts)	(thousands, except per-share amounts)		(thousands, except per-share amounts)	(thousands, except per-share amounts)	
As reported	\$ 66,788	\$ 30,380	\$ 0.34	\$ 167,816	\$ 76,681	\$ 0.86
Merger related expenses	30,493	25,780	0.29	49,072	44,359	0.50
Gain recognized from reduced Boise Investment, net of fees	(47,671)	(29,389)	(0.33)	(137,523)	(84,697)	(0.96)
Store closure charges	4,121	2,506	0.03	4,121	2,506	0.03
Severance charges				4,507	2,889	0.03
Dividend income from Boise Investment non-voting securities				(1,047)	(637)	(0.01)
Dividend income from Boise Investment voting securities	(25,372)	(15,642)	(0.17)	(25,372)	(15,642)	(0.17)
As adjusted	\$ 28,359	\$ 13,635	\$ 0.15	\$ 61,572	\$ 25,459	\$ 0.29



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	Non-GAAP Reconciliation			Prior Year Operating Results		
	Three Months Ended September 29, 2012			Nine Months Ended September 29, 2012		
	Operating income	Net income available to OfficeMax common shareholders	Diluted income per common share	Operating income	Net income available to OfficeMax common shareholders	Diluted income per common share
	(thousands, except per-share amounts)			(thousands, except per-share amounts)		
As reported	\$ 33,459	\$ 432,986	\$ 4.92	\$ 74,396	\$ 448,564	\$ 5.12
Store closure and asset impairment charges	11,432	6,973	0.08	36,698	22,411	0.26
Dividend income from Boise Investment non-voting securities	(2,169)	(1,323)	(0.02)	(6,307)	(3,847)	(0.05)
Gain on extinguishment of non-recourse debt		(416,390)	(4.73)		(416,390)	(4.73)
As adjusted	\$ 42,722	\$ 22,246	\$ 0.25	\$ 104,787	50,738	\$ 0.58

These items are described in more detail in this Management's Discussion and Analysis.

At the end of the third quarter of 2013, we had \$504.2 million in cash and cash equivalents and \$552.6 million in available (unused) borrowing capacity under our revolving credit facility. We also had outstanding recourse debt of \$232.4 million (both current and long-term) and non-recourse obligations of \$735.0 million related to the timber securitization notes at September 28, 2013. There is no recourse against OfficeMax on the securitized timber notes payable as recourse is limited to proceeds from the applicable pledged installment notes receivable and underlying guarantees. There were no borrowings on our credit agreement in 2013.

During the first nine months of 2013, we received \$205.6 million in cash proceeds related to the Boise Investment from the redemption of all of the non-voting equity securities at the original investment amount of \$66.0 million, and payment of \$46.1 million of accrued dividends on those securities as well as distributions of \$93.5 million related to the voting equity securities. The redemption of the non-voting equity securities and the majority of the distributions related to the voting equity securities reduced the carrying value of the Boise Investment, and resulted in the recognition of \$137.5 million of deferred gain, net of fees, associated with the Boise Investment (\$47.7 million in the third quarter.) In addition, \$25.4 million of the third quarter distribution related to the voting equity shares was recorded as dividend income.

For the first nine months of 2013, operations provided \$85.2 million of cash which included \$71.5 million of proceeds associated with our Boise Investment and \$17.2 million of payments associated with our proposed merger with Office Depot. Investing activities included \$134.1 million of proceeds associated with our Boise Investment, partially offset by \$65.3 million of capital expenditures (including systems and infrastructure investments). Financing activities used \$144.0 million, which included the payment of \$130.7 million associated with the Special Dividend.

**Operating Results**

Sales for the third quarter of 2013 decreased 4.6% year-over-year to \$1,664.9 million, while sales of \$4,964.6 million for the first nine months of 2013 decreased 4.9% year-over-year. After adjusting for the changes in foreign currency exchange rates, the impact of stores opened and closed in 2013 and 2012 and the difference in business days at the international Contract businesses, as they report on a calendar quarter basis which impacts the number of business days reported in a fiscal quarter from year to year for the consolidated company, sales for the third quarter of 2013 decreased 3.4% year-over-year, and sales for the first nine months of 2013 decreased 3.9% year-over-year. In our Retail segment, same-store sales in local currencies declined 2.8% in the third quarter of 2013 compared to the third quarter of 2012 and 4.0% for the first nine months of 2013 compared to the first nine months of 2012. In our Contract segment, sales in local currencies decreased 2.8% for the third quarter of 2013 compared to the third quarter of 2012 and 3.4% for the first nine months of 2013 compared to the first nine months of 2012.

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Gross profit margin decreased 1.3% of sales (130 basis points) to 25.1% of sales in the third quarter of 2013 and decreased 0.4% of sales (40 basis points) to 25.5% of sales in the first nine months of 2013 compared to the same respective periods in 2012. Gross profit margins in our Contract segment decreased year-over-year by 2.1% of sales (210 basis points) in the third quarter of 2013 and by 0.7% (70 basis points) in the first nine months of 2013, primarily due to lower customer margins, and the deleveraging impact of lower sales on occupancy and delivery expense, as well as higher delivery expense for the third quarter of 2013. Gross profit margins in our Retail segment decreased year-over-year by 0.4% (40 basis points) in the third quarter of 2013 compared to the comparable prior year period and were flat the first nine months of 2013 compared to the comparable prior year period, reflecting the negative impact of the expiration of favorable purchase accounting for leases related to the acquisition of the U.S. retail business, which benefitted the third quarter and first nine months of 2012 by \$2.7 million and \$8.1 million, respectively, and the deleveraging impact of lower sales on occupancy expenses. Customer margins were improved year-over-year for the first nine months of 2013, but were flat for the third quarter of 2013 compared to the same period of 2012.

As a result of purchase accounting from the 2003 acquisition of the U.S. retail business, we recorded an asset relating to store leases with terms below market value and a liability for store leases with terms above market value. The asset will be amortized through 2027 (\$4 million per year), while the liability was amortized through 2012 (\$11 million per year). From the acquisition date through 2012, the net amortization of these items reduced rent expense by approximately \$7 million per year. Beginning in 2013, the completed amortization of the liability, or expiration of the favorable purchase accounting, has resulted in no further reduction of rent expense causing 2013 gross profit to be lower than 2012 by approximately \$11 million for the year, or approximately \$3 million per quarter.

Operating, selling and general and administrative expenses decreased \$26.4 million year-over-year for the third quarter of 2013, primarily due to reduced payroll expense related to reorganizations and facility and store closures in 2012 and 2013, net favorable sales and property tax and legal settlements, lower advertising expense and lower incentive compensation expense, which were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. These expenses decreased \$40.4 million for the first nine months of 2013, primarily due to lower incentive compensation expense, reduced payroll expense related to reorganizations and facility and store closures in 2012 and 2013, lower advertising expense and net favorable sales and property tax and legal settlements, which were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. Incentive compensation expense was lower by \$3.8 million and \$21.8 million for the third quarter and first nine months of 2013, respectively. As a percentage of sales, operating, selling and general and administrative expenses decreased 0.4% of sales year-over-year to 23.4% of sales in the third quarter of 2013, primarily due to net favorable sales and property tax and legal settlements, lower incentive compensation expense and lower advertising expense, which were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. In the first nine months of 2013, as a percentage of sales, these expenses increased 0.4% of sales year-over-year to 24.2% of sales primarily due to the deleveraging impact of the lower sales on payroll and benefit costs and increased spending and depreciation associated with our growth and profitability initiatives, which were partially offset by lower incentive compensation expense, net favorable sales and property tax and legal settlements and lower advertising expense.

As noted above, our results for the first nine months of 2013 and 2012 included the following significant non-core items:

During the first nine months of 2013 and 2012, we recorded income of \$163.9 million and \$6.3 million, respectively, in our Corporate segment associated with our Boise Investment, consisting of \$47.7 million and \$137.5 million in the third quarter and first nine months of 2013, respectively, for the partial recognition of the deferred gain from the 2004 sale of our paper, forest products and timberland assets, net of fees, which were included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations; \$25.4 million for both the third quarter and first nine months of 2013 for dividend income from the voting securities, which were included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations;

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and \$1.0 million for the first nine months of 2013 (all in the first quarter) and \$2.2 million and \$6.3 million for the third quarter and first nine months of 2012, respectively, related to dividend income from the non-voting securities redeemed in the first quarter of 2013, which were included in operating, selling and general and administrative expenses in the Consolidated Statements of Operations. These items increased net income by \$45.0 million and \$1.3 million, or \$0.50 and \$0.02 per diluted share, for the third quarters of 2013 and 2012, respectively, and increased net income by \$101.0 million and \$3.8 million, or \$1.14 and \$0.05 per diluted share, for the first nine months of 2013 and 2012, respectively.

During the third quarter and first nine months of 2013, we recorded charges of \$30.5 million and \$49.1 million, respectively, in our Corporate segment for certain costs related to our proposed Merger with Office Depot, portions of which may not be deductible for tax purposes and were included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations. These charges reduced net income by \$25.8 million and \$44.4 million, or \$0.29 and \$0.50 per diluted share, for the third quarter and first nine months of 2013, respectively.

During the first nine months of 2013 (all in the second quarter), we recorded \$4.5 million of severance charges (\$4.3 million in our Contract segment and \$0.2 million in our Corporate and Other segment) related primarily to reorganizations in our sales and supply chain organizations in the U.S., New Zealand and Australia. These charges reduced net income by \$2.9 million, or \$0.03 per diluted share, for the first nine months of 2013.

The first nine months of 2013 and 2012 included charges recorded in our Retail segment related to store closures in the U.S. of \$4.1 million and \$26.9 million, respectively. The third quarter of 2013 and the first quarter of 2012 included charges of \$4.1 million and \$25.3 million, respectively, related to store closures in the U.S., and the third quarter of 2012 included a \$1.6 million charge related to a change in the estimated lease obligation of a previously closed domestic store. In addition, we recorded a charge of \$9.8 million for store asset impairments in the third quarter of 2012. The cumulative effect of these changes reduced net income available to OfficeMax common shareholders by \$2.5 million and \$22.4 million, or \$0.03 and \$0.26 per diluted share, for the first nine months of 2013 and 2012, respectively. These charges were included in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations.

The third quarter of 2012 included a non-cash gain of \$670.8 million related to an agreement that legally extinguished the Company's non-recourse debt guaranteed by Lehman. The gain increased net income available to OfficeMax common shareholders by \$416.4 million or \$4.73 per diluted share. This gain was included in gain on extinguishment of non-recourse debt in the Consolidated Statements of Operations.

Interest income was \$10.7 million and \$11.0 million for the third quarters of 2013 and 2012, respectively. For the first nine months of 2013 and 2012, interest income was \$32.2 million and \$32.8 million, respectively.

Interest expense was \$16.6 million in the third quarter of 2013 compared to \$16.9 million in the third quarter of 2012 and was \$50.0 million in the first nine months of 2013 compared to \$52.7 million in the first nine months of 2012.

For the third quarter of 2013, we recognized income tax expense of \$28.4 million on pre-tax income of \$60.7 million (effective tax expense rate of 46.8%) compared to income tax expense of \$263.3 million on pre-tax income of \$698.6 million (effective tax expense rate of 37.7%) for the third quarter of 2012. For the first nine months of 2013, we recognized income tax expense of \$68.7 million on pre-tax income of \$149.7 million (effective tax expense rate of 45.9%) compared to income tax expense of \$272.3 million on pre-tax income of \$725.7 million (effective tax expense rate of 37.5%) for the first nine months of 2012. The effective tax rate in both years was impacted by the effects of state income taxes, income items not subject to tax, non-deductible expenses (e.g. certain merger-related costs), income items not subject to tax and the mix of domestic and foreign sources of income, particularly the large gain in the U.S. from the non-recourse debt extinguishment in 2012.

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We reported net income attributable to OfficeMax and noncontrolling interest of \$32.3 million and \$81.0 million for the third quarter and first nine months of 2013, respectively. After adjusting for joint venture results attributable to noncontrolling interest and preferred dividends, we reported net income available to OfficeMax common shareholders of \$30.4 million, or \$0.34 per diluted share, for the third quarter of 2013 and net income available to OfficeMax common shareholders of \$76.7 million, or \$0.86 per diluted share, for the first nine months of 2013. Adjusted net income available to OfficeMax common shareholders, as discussed above, was \$13.6 million, or \$0.15 per diluted share, for the third quarter of 2013 compared to \$22.2 million, or \$0.25 per diluted share, for the third quarter of 2012. For the first nine months of 2013 and 2012, adjusted net income available to OfficeMax common shareholders was \$25.5 million, or \$0.29 per diluted share, for 2013 compared to \$50.7 million, or \$0.58 per diluted share, for 2012.

## ***Segment Discussion***

We report our results using three reportable segments: Contract; Retail; and Corporate and Other.

Contract distributes a broad line of items for the office, including office supplies and paper, technology products and solutions, office furniture, print and document services and facilities products. Contract sells directly to large corporate and government offices, as well as to small and medium-sized offices and consumers in the United States, Canada, Australia and New Zealand. This segment markets and sells through field salespeople, outbound telesales, catalogs, the Internet and in some markets, including Canada, Australia and New Zealand, through office products stores.

Retail is a retail distributor of office supplies and paper, print and document services, technology products and solutions, office furniture and facilities products. In addition, this segment contracts with large national retail chains to supply office and school supplies to be sold in their stores. Retail office supply stores feature OfficeMax ImPress, an in-store module devoted to print-for-pay and related services. Retail has operations in the United States, Puerto Rico and the U.S. Virgin Islands. Retail also operates office products stores in Mexico through a 51%-owned joint venture, Grupo OfficeMax S. de R.L. de C.V. ( Grupo OfficeMax ).

Corporate and Other includes corporate support staff services and certain other legacy expenses as well as the related assets and liabilities. The income and expense related to certain assets and liabilities that are reported in the Corporate and Other segment have been allocated to the Contract and Retail segments.

Management evaluates the segments' performances using segment income which is based on operating income after eliminating the effect of certain legacy operating items such as income associated with our Boise Investment and certain other operating items such as store closure costs, costs related to the proposed Merger with Office Depot, impairment charges and severance charges, all of which are not indicative of our core operations.

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(\$ in thousands)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Sales	\$ 841,866	\$ 880,898	\$ 2,612,819	\$ 2,720,320
Gross profit	174,134	200,889	568,587	612,279
<i>Gross profit margin</i>	20.7%	22.8%	21.8%	22.5%
Operating, selling and general and administrative expenses	165,315	174,404	527,283	533,003
<i>Percentage of sales</i>	19.6%	19.8%	20.2%	19.6%
Segment income	\$ 8,819	\$ 26,485	\$ 41,304	\$ 79,276
<i>Percentage of sales</i>	1.0%	3.0%	1.6%	2.9%
Sales by product line				
Office supplies and paper	\$ 482,226	\$ 506,015	\$ 1,510,302	\$ 1,551,322
Technology products	257,267	268,077	805,411	859,096
Office furniture	102,373	106,806	297,106	309,902
Sales by geography				
United States	\$ 597,329	\$ 619,411	\$ 1,810,165	\$ 1,869,399
International	244,537	261,487	802,654	850,921
<i>Sales growth (decline)</i>	(4.4)%	(0.3)%	(4.0)%	1.2%

Contract segment sales decreased 4.4% (2.8% in local currencies) year-over-year for the third quarter of 2013 to \$841.9 million. Sales for the first nine months of 2013 decreased 4.0% (3.4% in local currencies) year-over-year to \$2,612.8 million. The change in the number of business days year-over-year impacted sales by less than one percent for the third quarter and first nine months of 2013 each. U.S. sales decreased 3.6% and 3.2% for the third quarter and first nine months of 2013, respectively, as declines in our U.S. Workplace accounts were partially offset by increased sales in OfficeMax.com, one of our digital initiatives. The declines in our U.S. Workplace accounts were associated with declines in sales to existing customers in all three quarters of 2013. Sales to newly acquired customers were higher than sales from lost customers in the third quarter of 2013, but, for the first nine months of 2013, sales declines from lost customers were higher than sales to newly acquired customers. The rate of decline in sales to existing Workplace customers in the third quarter of 2013 of 5.0% was improved from the rate of decline noted in the second quarter of 2013. International sales decreased 6.5% (0.8% in local currencies) year-over-year for the third quarter of 2013 and decreased 5.7% (3.8% in local currencies) year-over-year for the first nine months of 2013. The change in the number of business days year-over-year benefitted international sales growth by less than one percent for the third quarter of 2013, and had no impact on international sales growth for the first nine months of 2013. The international sales declines were due primarily to lower sales to existing customers.

Contract segment gross profit margin decreased 2.1% (210 basis points) year-over-year to 20.7% for the third quarter of 2013 and decreased 0.7% (70 basis points) year-over-year to 21.8% for the first nine months of 2013. Gross profit margins in the U.S. were significantly lower in the third quarter of 2013 compared to the third quarter of 2012, due to lower customer margins from an increasingly competitive environment for existing and new business and higher delivery expenses. U.S. gross profit margins were slightly lower in the first nine months of 2013 than in the first nine months of 2012 due to higher delivery expenses. In the international Contract businesses, gross profit margins were lower in the third quarter and first nine months of 2013 compared to the same periods of 2012, primarily due to lower customer margins resulting from increased competition and a change in product mix to more lower margin on-contract priced products, as well as the deleveraging impact of lower sales on occupancy expenses.



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Contract segment operating, selling and general and administrative expenses decreased \$9.1 million for the third quarter of 2013 compared to the third quarter of 2012, as the favorable impact of changes in foreign exchange rates, lower incentive compensation expense and net favorable legal and sales tax settlements were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. These expenses decreased \$5.7 million for the first nine months of 2013 compared to the first nine months of 2012, as lower incentive compensation expense and the favorable impact of changes in foreign exchange rates were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. Incentive compensation expense was lower by \$3.2 million and \$11.9 million for the third quarter and first nine months of 2013, respectively. As a percentage of sales, these expenses decreased 0.2% year-over-year to 19.6% of sales for the third quarter of 2013, as lower incentive compensation expense and net favorable legal and sales tax settlements were partially offset by increased spending and depreciation associated with our growth and profitability initiatives and the deleveraging impact of lower sales on payroll and benefits costs. For the first nine months of 2013, as a percentage of sales, these expenses increased 0.6% year-over-year to 20.2% of sales as the deleveraging impact of lower sales on payroll and benefits costs and increased spending and depreciation associated with our growth and profitability initiatives were partially offset by lower incentive compensation expense.

Contract segment income was \$8.8 million, or 1.0% of sales, for the third quarter of 2013, compared to \$26.5 million, or 3.0% of sales, for the third quarter of 2012. Contract segment income was \$41.3 million, or 1.6% of sales, for the first nine months of 2013 compared to \$79.3 million, or 2.9% of sales, for the first nine months of 2012. The decrease in segment income for both periods was primarily attributable to the lower sales and lower gross profit margins, partially offset by the lower operating, selling and general and administrative expenses.

**Retail**

(\$ in thousands)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Sales	\$ 822,993	\$ 863,681	\$ 2,351,818	\$ 2,499,570
Gross profit	243,352	259,513	695,196	740,413
<i>Gross profit margin</i>	29.6%	30.0%	29.6%	29.6%
Operating, selling and general and administrative expenses	217,129	231,780	650,807	687,013
<i>Percentage of sales</i>	26.4%	26.8%	27.7%	27.5%
Segment income	\$ 26,223	\$ 27,733	\$ 44,389	\$ 53,400
<i>Percentage of sales</i>	3.2%	3.2%	1.9%	2.1%
Sales by product line				
Office supplies and paper	\$ 377,018	\$ 391,271	\$ 996,394	\$ 1,045,133
Technology products	378,426	402,920	1,155,275	1,252,601
Office furniture	67,549	69,490	200,149	201,836
Sales by geography				
United States	\$ 742,986	\$ 789,278	\$ 2,136,043	\$ 2,297,221
International	80,007	74,403	215,775	202,349
Sales growth (decline)	(4.7)%	(3.1)%	(5.9)%	(3.7)%
Same-location sales growth (decline)	(2.8)%	(2.1)%	(4.0)%	(1.5)%

Retail segment sales decreased by 4.7% year-over-year (5.1% on a local currency basis) to \$823.0 million for the third quarter of 2013 and by 5.9% year-over-year (6.3% on a local currency basis) to \$2,351.8 million for the first nine months of 2013, in both cases reflecting store closures and reduced store traffic. U.S. same-store

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sales declined 2.8% year-over-year for the third quarter and 4.1% for the first nine months of 2013, in both cases primarily due to lower store traffic and lower technology product category sales. Mexico same-store sales decreased 2.2% and 2.5% year-over-year on a local currency basis for the third quarter and first nine months of 2013, respectively, reflecting a weakening Mexican economy and lower technology product sales. We ended the third quarter of 2013 with 921 stores. In the U.S., we closed 24 retail stores during the first nine months of 2013 (fifteen in the third quarter) and opened one (in the third quarter) during the first nine months of 2013, ending the third quarter with 828 retail stores. Grupo OfficeMax opened five stores during the first nine months of 2013 (three in the third quarter) and closed two (none in the third quarter), ending the quarter with 93 retail stores.

Retail segment gross profit margins of 29.6% of sales for both the third quarter and the first nine months of 2013 decreased year-over-year by 0.4% (40 basis points) in the third quarter of 2013 and were flat in the first nine months of 2013 compared to the comparable prior year periods. Gross profit margins declined in the U.S. for the third quarter of 2013 but increased for the first nine months, as both periods were affected by the negative impact of the expiration of favorable purchase accounting for leases related to the acquisition of the U.S. retail business, which benefitted the prior year period by \$2.7 million and \$8.1 million for the third quarter and first nine months of 2013, respectively, and the deleveraging impact of lower sales on occupancy expenses. Both periods benefitted from higher customer margins, but the third quarter customer margin improvement was not enough to offset the occupancy expense impact. Gross profit margins were lower year-over-year in Mexico for both the third quarter and the first nine months of 2013.

Retail segment operating, selling and general and administrative expenses decreased \$14.7 million for the third quarter of 2013 compared to the third quarter of 2012 primarily due to lower payroll and benefit expense from cost management and store closures, lower advertising expense and favorable sales and property tax settlements. These expenses decreased \$36.2 million year-over-year for first nine months of 2013 compared to the first nine months of 2012 primarily due to lower payroll and benefit expense from cost management and store closures, lower advertising expense, reduced incentive compensation expense and favorable sales and property tax settlements, which were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. Incentive compensation expense was lower by \$0.8 million and \$9.1 million for the third quarter and first nine months of 2013, respectively. Retail segment operating, selling and general and administrative expenses as a percentage of sales decreased 0.4% of sales year-over-year to 26.4% of sales for the third quarter of 2013 primarily due to favorable sales and property tax settlements, lower payroll and benefit expense from cost management and store closures, and lower advertising expense, which were partially offset by increased spending and depreciation associated with our growth and profitability initiatives. For the first nine months of 2013, as a percentage of sales, these expenses increased 0.2% of sales year-over-year to 27.7% of sales primarily due to increased spending and depreciation associated with our growth and profitability initiatives and the deleveraging impact of the lower sales on payroll and benefit expense, which were partially offset by reduced incentive compensation expense, lower advertising expense and favorable sales and property tax settlements.

Retail segment income was \$26.2 million, or 3.2% of sales, for the third quarter of 2013, compared to \$27.7 million, or 3.2% of sales, for the third quarter of 2012. Retail segment income was \$44.4 million, or 1.9% of sales, for the first nine months of 2013 compared to \$53.4 million, or 2.1% of sales, for the first nine months of 2012. The decrease in segment income for both periods was attributable to the lower sales, which was partially offset by the lower operating, selling and general and administrative expenses and, for the third quarter, to lower gross profit margins which were affected by the negative impact of the expiration of favorable purchase accounting for leases related to the acquisition of the U.S. retail business.

***Corporate and Other***

Corporate and Other segment loss was \$6.7 million and \$24.1 million for the third quarter and first nine months of 2013, respectively, compared to \$11.5 million and \$27.9 million for the third quarter and first nine months of 2012, respectively, primarily due to favorable sales tax settlements and cost reductions.

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### ***Liquidity and Capital Resources***

At the end of the third quarter of 2013, the total liquidity available for OfficeMax was \$1,056.8 million. This includes cash and cash equivalents of \$504.2 million, including \$124.2 million in foreign cash balances, and borrowing availability of \$552.6 million from our credit agreement associated with the Company and certain of our subsidiaries in the U.S., Puerto Rico and Canada. At the end of the third quarter of 2013, the Company was in compliance with all covenants under the credit agreement. The credit agreement expires on October 7, 2016. At the end of the third quarter of 2013, we had \$232.4 million of short-term and long-term recourse debt and \$735.0 million of non-recourse timber securitization notes outstanding.

Under certain circumstances there are restrictions on our ability to repatriate certain amounts of foreign cash balances. If the Company chose to repatriate certain unrestricted foreign cash balances, it could result in a repatriation provision of approximately \$0.9 million in excess of the amount already accrued and \$2.9 million in cash taxes due.

Our primary ongoing cash requirements relate to working capital, expenditures for property and equipment, technology enhancements and upgrades, lease obligations, pension funding and debt service. We expect to fund these requirements through a combination of available cash balances and cash flow from operations. We also have the revolving credit facility as additional liquidity. The following sections of this Management's Discussion and Analysis of Financial Condition and Results of Operations discuss in more detail our operating, investing, and financing activities, as well as our financing arrangements.

### ***Operating Activities***

Our operating activities provided cash of \$85.2 million in the first nine months of 2013 compared to \$157.8 million in the first nine months of 2012. Cash from operations for 2013 was lower than the prior year primarily reflecting unfavorable working capital changes, lower adjusted income, increased payments associated with our incentive compensation plans and payments associated with our proposed merger with Office Depot which were partially offset by the receipt of cash associated with our Boise Investment.

Cash flow from operations for the first nine months of 2013 included \$46.1 million of cash received from the collection of the accrued dividends on the non-voting securities of our Boise Investment and \$25.4 million of dividends received during the third quarter of 2013 associated with the voting securities of our Boise Investment. Cash flow from operations also included \$17.2 million of payments associated with our proposed merger with Office Depot. The first nine months of 2013 included incentive compensation payments of approximately \$28 million related to the 2012 annual incentive plan, while the first nine months of 2012 reflected minimal payments related to incentive compensation as performance targets generally were not achieved for the 2011 annual incentive plan. Collections from our domestic receivables were lower in 2013 than in 2012 as there was unusually high vendor-supported promotional activity at year-end 2011 that caused collections to be unusually high at the beginning of 2012. There were also significant timing differences in vendor payments. At year end 2012, we deferred certain payments into 2013 resulting from late reconciliation issues at the end of 2012 that were resolved in the first quarter of 2013, and the first nine months of 2013 included an increased amount of payments due to the timing of other expenses for our initiatives at year-end 2012.

We sponsor noncontributory defined benefit pension plans covering certain terminated employees, vested employees, retirees, and some active employees, primarily in Contract. Pension expense was \$1.8 million and \$2.5 million for the first nine months of 2013 and 2012, respectively. In the first nine months of 2013 and 2012, we made cash contributions to our pension plans totaling \$2.3 million and \$20.2 million, respectively. The estimated minimum required funding contribution in 2013 is approximately \$3.0 million and the expense in 2013 is projected to be approximately \$2.4 million compared to expense of \$3.3 million in 2012. In 2011, we elected funding relief for our qualified pension plans under the Pension Relief Act of 2010 that deferred a portion of required contributions to our pension plans to later years. However, as the Special Dividend is considered to be an excess shareholder payment under the Pension Relief Act of 2010, we expect to be required to forgo the funding relief and to make an additional contribution of approximately \$20 million in 2014, as the previously

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deferred contributions are accelerated. Including this additional contribution, we expect to make approximately \$50 million of contributions to our pension plans in 2014, which we expect to fund with cash. In addition, we may elect to make additional voluntary contributions in either year.

*Investing Activities*

Our investing activities provided \$71.7 million of cash in the first nine months of 2013, compared to using \$46.5 million in the first nine months of 2012. Cash flow from investing activities for the first nine months of 2013 included \$134.1 million relating to the Boise Investment, consisting of \$66.0 million associated with the redemption of the Boise Investment non-voting securities and \$68.1 million associated with distributions related to the Boise Investment voting securities.

In the first nine months of 2013, capital spending of \$65.3 million consisted of system improvements relating to our growth initiatives, overall software enhancements and infrastructure improvements, as well as spending on new stores and relocations in Mexico and the U.S. We expect our capital investments in 2013 to be approximately \$80 million to \$90 million. Our capital spending in 2013 will be primarily for maintenance and investment in our systems, infrastructure and growth and profitability initiatives.

*Financing Activities*

Our financing activities used cash of \$144.0 million and \$35.7 million in the first nine months of 2013 and 2012, respectively. In the third quarter of 2013, we paid \$130.7 million related to the Special Dividend, with the remaining \$0.8 million to be paid in the future upon vesting of certain RSUs. Net debt payments were \$3.8 million and \$31.9 million in the first nine months of 2013 and 2012, respectively, as we repaid a \$35 million medium-term note that had reached maturity in the first nine months of 2012.

We suspended our dividend to shareholders of common stock on December 18, 2008. In July 2012, we reinstated the payment of quarterly cash dividends on our common stock. The quarterly dividends are expected to be \$0.02 per common share, or \$0.08 per common share on an annualized basis, with the quarterly dividend declared on October 22, 2013 to be paid on November 15, 2013 to shareholders of record as of November 1, 2013. During the first nine months of 2013, we paid \$5.2 million in quarterly common stock dividends.

*Financing Arrangements*

We lease our store space and certain other property and equipment under operating leases. These operating leases are not included in debt; however, they represent a significant commitment. Our obligations under operating leases are shown in the Contractual Obligations section in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 29, 2012.

Our debt structure consists of a credit agreement, note agreements, and other borrowings as described below. For more information, see the Contractual Obligations and Disclosures of Financial Market Risks sections of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

*Credit Agreement*

On October 7, 2011, we entered into a Second Amended and Restated Loan and Security Agreement (the Credit Agreement) with a group of banks. The Credit Agreement amended both our then existing credit agreement to which we were a party along with certain of our subsidiaries in the U.S. and our then existing credit agreement to which our subsidiary in Canada was a party and consolidated them into a single credit agreement. The Credit Agreement permits us to borrow up to a maximum of \$650 million, of which \$50 million is allocated to our Canadian subsidiary, and \$600 million is allocated to the Company and its other participating U.S. subsidiaries, subject to a borrowing base calculation that limits availability to a percentage of eligible trade and

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credit card receivables plus a percentage of the value of eligible inventory less certain reserves. The Credit Agreement may be increased (up to a maximum of \$850 million) at our request and the approval of the lenders participating in the increase, or may be reduced from time to time at our request, in each case according to the terms detailed in the Credit Agreement. Letters of credit, which may be issued under the Credit Agreement up to a maximum of \$250 million, reduce available borrowing capacity. Stand-by letters of credit issued under the Credit Agreement totaled \$37.8 million at the end of the third quarter of 2013. At the end of the third quarter of 2013, the maximum aggregate borrowing amount available under the Credit Agreement was \$590.4 million and availability under the Credit Agreement totaled \$552.6 million. At the end of the third quarter of 2013, we were in compliance with all covenants under the Credit Agreement. The Credit Agreement allows the payment of dividends, subject to availability restrictions and if no default has occurred, and it expires on October 7, 2016, although the Company may terminate it earlier upon prior notice. If the Credit Agreement has not been terminated or amended prior to completion of the Merger, the Merger will result in a default under the Credit Agreement.

Borrowings under the Credit Agreement are subject to interest at rates based on either the prime rate, the federal funds rate, LIBOR or the Canadian Dealer Offered Rate. An additional percentage, which varies depending on the level of average borrowing availability, is added to the applicable rates. Fees on letters of credit issued under the Credit Agreement are charged at rates between 1.25% and 2.25% depending on the type of letter of credit (i.e., stand-by or commercial) and the level of average borrowing availability. The Company is also charged an unused line fee of between 0.375% and 0.5% on the amount by which the maximum available credit exceeds the average daily outstanding borrowings and letters of credit. The fees on letters of credit were 1.75% and the unused line fee was 0.5% at September 28, 2013.

*Timber Notes/Non-Recourse Debt*

In October 2004, we sold our timberland assets in exchange for \$15 million in cash plus credit-enhanced timber installment notes in the amount of \$1,635 million (the *Installment Notes*). The *Installment Notes* were issued by single-member limited liability companies formed by affiliates of Boise Cascade, L.L.C. (the *Note Issuers*). In order to support the issuance of the *Installment Notes*, the *Note Issuers* transferred a total of \$1,635 million in cash to Lehman Brothers Holdings, Inc. ( *Lehman* ) and Wells Fargo & Company ( *Wells* ) (which at the time was Wachovia Corporation) (\$817.5 million to each of Lehman and Wells) who issued collateral notes (the *Collateral Notes*) to the *Note Issuers* and guaranteed the respective *Installment Notes*. In December 2004, we completed a securitization transaction in which the Company's interests in the *Installment Notes* and related guarantees were transferred to wholly-owned bankruptcy remote subsidiaries. The subsidiaries pledged the *Installment Notes* and related guarantees and issued securitized notes (the *Securitization Notes*) in the amount of \$1,470 million. Recourse on the *Securitization Notes* is limited to the proceeds of the applicable pledged *Installment Notes* and underlying Lehman or Wells guaranty. **As a result, there is no recourse against OfficeMax, and the Securitization Notes have been reported as non-recourse debt in our Consolidated Balance Sheets.**

On September 15, 2008, Lehman, the guarantor of half of the *Installment Notes* and the *Securitization Notes*, filed a petition in the United States Bankruptcy Court for the Southern District of New York seeking relief under chapter 11 of the United States Bankruptcy Code. Lehman's bankruptcy filing constituted an event of default under the \$817.5 million *Installment Note* guaranteed by Lehman (the *Lehman Guaranteed Installment Note*). During the third quarter of 2012, we entered into an agreement that extinguished the *Securitization Notes* guaranteed by Lehman. Upon effectiveness of the agreement, the trustee for the *Securitization Note* holders released OfficeMax and its affiliates from the non-recourse liabilities following the transfer from OfficeMax to the trustee for the *Securitization Note* holders of the claims arising from the bankruptcy, the *Lehman Guaranteed Installment Note* and the related guaranty.

At the time of the sale of the timberlands in 2004, we generated a tax gain and recognized the related deferred tax liability. The timber installment notes structure allowed the Company to defer the resulting tax liability of \$529 million until 2020, the maturity date for the *Installment Notes*. In the third quarter of 2012, as a

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result of the agreement transferring our rights to the remaining receivable and the extinguishment of Securitization Notes guaranteed by Lehman, \$269 million of the deferred tax gain was recognized. Due to available alternative minimum tax credits and net operating losses, which offset a significant portion of the taxable income, the Company made a cash tax payment of \$15 million in the fourth quarter of 2012. At September 28, 2013, the remaining deferred tax gain of \$260 million is related to the Installment Notes guaranteed by Wells (the Wells Guaranteed Installment Notes ), and will be recognized upon maturity.

Through September 28, 2013, we have received all payments due under the Wells Guaranteed Installment Notes, which have consisted only of interest due on the notes, and have made all payments due on the related Securitization Notes guaranteed by Wells, again consisting only of interest due. As all amounts due on the Wells Guaranteed Installment Notes are current and we have no reason to believe that we will not be able to collect all amounts due according to the contractual terms of the Wells Guaranteed Installment Notes, the notes are reflected in our Consolidated Balance Sheets at their original principal amount of \$817.5 million. An additional adverse impact on our financial results presentation could occur if Wells Fargo & Company became unable to perform its obligations under the Wells Guaranteed Installment Notes, thereby resulting in a significant impairment impact.

The Wells Guaranteed Installment Notes and related Securitization Notes are scheduled to mature in 2020 and 2019, respectively. The Securitization Notes have an initial term that is approximately three months shorter than the Wells Guaranteed Installment Notes. We expect that if the Securitization Notes are still outstanding in 2019, we will refinance them with a short-term borrowing to bridge the period from initial maturity of the Securitization Notes to the maturity of the Wells Guaranteed Installment Notes.

***Boise Investment***

In connection with the sale of the paper, forest products and timberland assets in 2004, we invested \$175 million in affiliates of Boise Cascade, L.L.C. Due to restructurings conducted by those affiliates, our investment is currently in Boise Cascade Holdings, L.L.C. ( BCH ), a building products company.

Our investment in BCH (the Boise Investment ) is accounted for under the cost method, as BCH does not maintain separate ownership accounts for its members' interests, and we do not have the ability to significantly influence the operating and financial policies of BCH. In exchange for investing in BCH, we received voting equity securities and non-voting equity securities.

A subsidiary of BCH, Boise Cascade, L.L.C., filed a registration statement with the SEC in November 2012 to register stock for an initial public offering (the Boise IPO ). Boise Cascade, L.L.C. completed the Boise IPO on February 11, 2013 and became Boise Cascade Company ( BCC ). In connection with the Boise IPO, BCH's equity interest in Boise Cascade, L.L.C. was automatically exchanged for 29.7 million shares of common stock of BCC. Subsequent to the Boise IPO, BCH executed a Fourth Amended and Restated Operating Agreement on February 26, 2013, pursuant to which BCH's then-existing Series B and Series C common units were exchanged for newly issued common units of Boise Cascade Holdings L.L.C., after which OfficeMax owns 5.9 million of the outstanding 29.7 million common units of BCH, representing a 20.01% ownership interest in BCH.

The non-voting securities of BCH were redeemed at the original investment amount of \$66 million in February 2013. Prior to the redemption, the non-voting securities accrued dividends daily at the rate of 8% per annum on the liquidation value plus the accumulated dividends. These dividends accumulated semiannually to the extent not paid in cash on the last day of June and December. The accumulated dividend receivable on the non-voting securities of \$46.1 million was also collected in February 2013. Our policy was to record the income associated with dividends on the non-voting securities as a reduction of operating, selling and general and administrative expenses in the Consolidated Statements of Operations. The income associated with the dividends on the non-voting securities ceased in the first quarter of 2013 as a result of the redemption of those securities. The Company recognized dividend income on the non-voting securities of \$1.0 million in 2013 (all in the first quarter) prior to the redemption, and \$2.2 million and \$6.3 million during the third quarter and first nine months of 2012, respectively.

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The voting securities do not accrue dividends. However, in February and April 2013, we received distributions of \$17.3 million and \$4.4 million, respectively, related to the voting securities. Based on the accumulated earnings of BCH, these distributions were recorded as reductions in the carrying value of the Boise Investment.

In July 2013, we received a \$71.8 million distribution resulting from BCH's sale of 13.9 million common shares of BCC through a secondary public offering and a repurchase by BCC, from BCH, of 3.9 million shares BCC common stock. Following these transactions, BCH owns 15.8 million shares of BCC common stock. Based on the accumulated earnings of BCH, \$46.4 million of the \$71.8 million distribution was recorded as a reduction in the carrying value of the Boise Investment. The remaining \$25.4 million was recorded as income from dividends on the voting securities in asset impairments and other operating expenses (income), net in the Consolidated Statement of Operations. BCH's sale of BCC shares is expected to result in OfficeMax being allocated taxable income as a partner of the BCH entity. This allocation of taxable income, in turn, might result in cash taxes being due for the year when combined with OfficeMax's other taxable income or loss and credits.

The Boise Investment represented a continuing involvement in the operations of the business we sold in 2004. Therefore, \$179.8 million of gain realized from the sale was deferred. The redemption of the non-voting equity securities, as well as the portion of the distributions related to the voting equity securities that were recorded as reductions of the carrying value of Boise Investment, triggered recognition of pre-tax operating gains from partial recognition of the deferred gain, approximately \$47.7 million and \$137.7 million was recorded in the third quarter and nine months ended September 28, 2013, respectively. The gains were reported in asset impairments and other operating expenses (income), net in the Consolidated Statements of Operations for the third quarter and first nine months of 2013, respectively. The remaining \$42.0 million of deferred gain attributable to the voting equity securities will be recognized in earnings as the Company's investment is reduced.

On October 28, 2013, BCC filed a registration statement for the sale of 8,000,000 shares held by BCH at a maximum selling price of \$27.095 per share. Assuming BCH distributes the proceeds from this sale to its shareholders, OfficeMax expects to receive 20.01% of such distribution.

As of September 28, 2013, based on the trading value of the publicly traded shares of BCC on that date, there was no indication of impairment of the Boise Investment.

### ***Contractual Obligations***

For information regarding contractual obligations, see the caption "Contractual Obligations" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 29, 2012. At September 28, 2013, there had not been a material change to the information regarding contractual obligations disclosed in our Annual Report on Form 10-K for the year ended December 29, 2012.

In accordance with an amended and restated joint venture agreement, the minority owner of Grupo OfficeMax, our joint-venture in Mexico, can elect to require OfficeMax to purchase the minority owner's 49% interest in the joint venture if certain earnings targets are achieved. Earnings targets are calculated quarterly on a rolling four-quarter basis. Accordingly, the targets may be achieved in one quarter but not in the next. If the earnings targets are achieved and the minority owner elects to require OfficeMax to purchase the minority owner's interest, the purchase price is based on the joint venture's earnings and the current market multiples of similar companies. At the end of the third quarter of 2013, Grupo OfficeMax met the earnings targets and the estimated purchase price of the minority owner's interest was \$61.1 million. This represents an increase in the estimated purchase price from the prior year which is attributable to higher market multiples for similar companies as of the measurement date. As the estimated purchase price was greater than the carrying value of the noncontrolling interest as of the end of the year, the Company recorded an adjustment to state the noncontrolling interest at the estimated purchase price, and, as the estimated purchase price approximates fair value, the offset was recorded to additional paid-in capital.

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### ***Off-Balance-Sheet Activities and Guarantees***

For information regarding off-balance-sheet activities and guarantees, see *Off-Balance-Sheet Activities and Guarantees* in *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations* in our Annual Report on Form 10-K for the year ended December 29, 2012. At September 28, 2013, there had not been a material change to the information regarding off-balance-sheet activities and guarantees disclosed in our Annual Report on Form 10-K for the year ended December 29, 2012.

### ***Seasonal Influences***

Our business is seasonal, with Retail showing a more pronounced seasonal trend than Contract. Sales in the second quarter are historically the slowest of the year. Sales are stronger during the first, third and fourth quarters which include the important new-year office supply restocking month of January, the back-to-school period and the holiday selling season, respectively.

### ***Disclosures of Financial Market Risks***

#### ***Financial Instruments***

Our debt is predominantly fixed-rate. At September 28, 2013, the estimated current fair value of our debt, based on quoted market prices when available or then-current interest rates for similar obligations with like maturities, including the timber notes, was approximately \$118 million more than the amount of debt reported in the Consolidated Balance Sheets. As previously discussed, there is no recourse against OfficeMax on the securitized timber notes payable as recourse is limited to proceeds from the applicable pledged Installment Notes receivable and underlying guarantees. The debt and receivables related to the timber notes have fixed interest rates and are reflected in the tables below, along with the carrying amounts and estimated fair values.

We were not a party to any material derivative financial instruments in 2013 or 2012.

The following table provides information about our financial instruments outstanding at September 28, 2013. The following table does not include our obligations for pension plans and other post retirement benefits, although market risk also arises within our defined benefit pension plans to the extent that the obligations of the pension plans are not fully matched by assets with determinable cash flows. We sponsor noncontributory defined benefit pension plans covering certain terminated employees, vested employees, retirees, and some active OfficeMax employees. As our plans were frozen in 2003, our active employees and all inactive participants who are covered by the plans are no longer accruing additional benefits. However, the pension plan obligations are still subject to change due to fluctuations in long-term interest rates as well as factors impacting actuarial valuations, such as retirement rates and pension plan participants' increased life expectancies. In addition to changes in pension plan obligations, the amount of plan assets available to pay benefits, contribution levels and expense are also impacted by the return on the pension plan assets. The pension plan assets include OfficeMax common stock, U.S. equities, international equities, global equities and fixed-income securities, the cash flows of which change as equity prices and interest rates vary. The risk is that market movements in equity prices and interest rates could result in assets that are insufficient over time to cover the level of projected obligations. This in turn could result in significant changes in pension expense and funded status, further impacting future required contributions. Management, together with the trustees who act on behalf of the pension plan beneficiaries, assess the level of this risk using reports prepared by independent external actuaries and take action, where appropriate, in terms of setting investment strategy and agreed contribution levels.



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	September 28, 2013		December 29, 2012	
	Carrying amount	Fair value	Carrying amount	Fair value
(millions)				
<b>Financial assets:</b>				
Timber notes receivable	\$ 817.5	\$ 938.3	\$ 817.5	\$ 986.4
Boise Investment	\$ 40.9	\$ 85.4		
<b>Financial liabilities:</b>				
Recourse debt	\$ 232.4	\$ 228.4	\$ 236.2	\$ 229.4
Non-recourse debt	\$ 735.0	\$ 857.0	\$ 735.0	\$ 903.9

Prior to the first quarter of 2013, it was not considered practicable to estimate the fair value of the Boise Investment. Boise Cascade Holdings, L.L.C. and its subsidiaries were untraded companies without observable market inputs. However, as discussed in Note 8, Investment in Boise Cascade Holdings, L.L.C., Boise Cascade Company became a publicly traded company through the Boise IPO executed in the first quarter of 2013. As of September 28, 2013, the Boise Investment constitutes an indirect interest in Boise Cascade Company's publicly traded securities (NYSE: BCC). The availability of quoted market prices for the indirect investment made the estimate of fair value practicable beginning in the first quarter of 2013.

Changes in foreign currency exchange rates expose us to financial market risk. We occasionally use derivative financial instruments, such as forward exchange contracts, to manage our exposure associated with commercial transactions and certain liabilities that are denominated in a currency other than the currency of the operating unit entering into the underlying transaction. We generally do not enter into derivative instruments for any other purpose. We do not speculate using derivative instruments.

The estimated fair values of our other financial instruments, including cash and cash equivalents and receivables are the same as their carrying values. Concentration of credit risks with respect to trade receivables is limited due to the wide variety of vendors, customers and channels to and through which our products are sourced and sold, as well as their dispersion across many geographic areas. In the fourth quarter of 2011, we became aware of financial difficulties at one of our large Contract customers. We granted the customer extended payment terms and implemented creditor oversight provisions. The receivable from this customer was \$33.7 million at September 28, 2013, and a significant portion of that balance has been collected to date. Based on our ongoing sales to this customer, we continue to carry similar receivable balances, which we monitor closely.

*Facility Closure Reserves*

We conduct regular reviews of our real estate portfolio to identify underperforming facilities, and close those facilities that are no longer strategically or economically beneficial. We record a liability for the cost associated with a facility closure at its estimated fair value in the period in which the liability is incurred, primarily the location's cease-use date. Upon closure, unrecoverable costs are included in facility closure reserves and include provisions for the present value of future lease obligations, less contractual or estimated sublease income. Accretion expense is recognized over the life of the payments.

During the first nine months of 2013, we recorded facility closure charges of \$4.1 million (all in the third quarter) in our Retail segment associated with the closing of six underperforming domestic stores prior to the end of their lease terms. During the first nine months of 2012, we recorded facility closure charges of \$26.9 million in our Retail segment, of which \$1.6 million was recorded in the third quarter related to a change in the estimated lease obligation of a previously closed domestic store and \$25.3 million was recorded in the first quarter primarily related to the closure of 15 underperforming domestic stores prior to the end of their lease terms.

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At September 28, 2013, the facility closure reserve was \$60.1 million with \$19.3 million included in current liabilities, and \$40.8 million included in long-term liabilities. The reserve represents future lease obligations of \$102.4 million, net of anticipated sublease income of approximately \$42.2 million. Cash payments relating to the facility closures were \$21.2 million and \$15.3 million in the first nine months of 2013 and 2012, respectively.

***Environmental***

For information regarding environmental issues, see the caption *Environmental* in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 29, 2012. At September 28, 2013, there has not been a material change to the information regarding environmental issues disclosed in the Company's Annual Report on Form 10-K for the year ending December 29, 2012.

***Critical Accounting Estimates***

For information regarding critical accounting estimates, see the caption *Critical Accounting Estimates* in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 29, 2012. There have been no significant changes to the Company's critical accounting estimates during the first nine months of 2013.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For information regarding market risk see the caption *Disclosures of Financial Market Risks* herein and in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 29, 2012. At September 28, 2013, except as disclosed herein in *Disclosures of Financial Market Risks*, there had not been a material change to the information regarding market risk disclosed in the Company's Annual Report on Form 10-K for the year ended December 29, 2012.

**ITEM 4. CONTROLS AND PROCEDURES**

***(a) Evaluation of Disclosure Controls and Procedures***

As of the end of the period covered by this report, the chief executive officer and chief financial officer directed and supervised an evaluation of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the *Exchange Act*)). The evaluation was conducted to determine whether the Company's disclosure controls and procedures were effective in bringing material information about the Company to the attention of senior management. Based on this evaluation, our chief executive officer and chief financial officer concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective in alerting them in a timely manner to material information that the Company is required to disclose in its filings with the Securities and Exchange Commission.

***(b) Changes in Internal Control Over Financial Reporting***

There was no change in the Company's internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act, during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

We are involved in litigation and administrative proceedings arising in the normal course of our business. In the opinion of management, our recovery, if any, or our liability, if any, under pending litigation or administrative proceedings would not materially affect our financial position, results of operations or cash flows. For information concerning legal proceedings, see Note 16, Legal Proceedings and Contingencies, of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data in the Company's Annual Report on Form 10-K for the year ended December 29, 2012.

**Litigation Related to the Proposed Merger**

As previously disclosed, eight putative class action lawsuits challenging the Merger were filed on behalf of a putative class consisting of OfficeMax stockholders.

Six lawsuits were filed in the Circuit Court of the Eighteenth Judicial Circuit of DuPage County, Illinois (the State Court): (i) Venkata S. Donepudi v. OfficeMax Incorporated, et al. (Case Number 2013L000188), filed on February 25, 2013; (ii) Beth Koeneke v. OfficeMax Incorporated, et al. (Case Number 2013CH000776), filed on February 28, 2013; (iii) Marc Schmidt v. Saligram, et al. (Case Number 2013MR000411), filed on March 13, 2013; (iv) The Feivel & Helene Gottlieb Defined Benefit Pension Plan v. OfficeMax Incorporated, et al. (Case Number 2013L000246), filed on March 14, 2013; (v) Norman Klumpp v. Bryant, et al. (Case Number 2013CH1107), filed on March 28, 2013; and (vi) J. David Lewis v. OfficeMax Incorporated, et al. (Case Number 2013CH001123), filed on March 29, 2013. The above-referenced actions have been consolidated in Venkata S. Donepudi v. OfficeMax Incorporated, et al. (Case Number 2013L000188) (the State Action). A consolidated amended class action complaint was filed in the State Action on April 25, 2013.

Two lawsuits were filed in the United States District Court for the Northern District of Illinois, Eastern Division: (i) Eric Hollander v. OfficeMax Incorporated, et al. (Case Number 1:13-cv-03330), filed on May 2, 2013; and (ii) Thomas and Beverly DeFabio v. OfficeMax Incorporated, et al. (Case Number 1:13-cv-03385), filed on May 6, 2013 (the Federal Actions).

The State Action and the Federal Actions named OfficeMax, Office Depot and the directors of OfficeMax, among others, as defendants. Each of the lawsuits was brought by a purported holder or holders of OfficeMax common stock, both individually and on behalf of a putative class of OfficeMax stockholders. The lawsuits generally alleged, among other things, that the directors of OfficeMax breached their fiduciary duties to OfficeMax stockholders by agreeing to a transaction with inadequate and unfair consideration and pursuant to an inadequate and unfair process. The lawsuits further allege that OfficeMax and Office Depot, among others, aided and abetted the OfficeMax directors in the breach of their fiduciary duties. In addition, the lawsuits alleged that the disclosure in the definitive joint proxy statement/prospectus of OfficeMax and Office Depot filed with the SEC on June 10, 2013 was inadequate.

OfficeMax believes that these lawsuits are without merit and that no further disclosure was required to supplement the joint proxy statement/prospectus under applicable laws; however, to eliminate the burden, expense and uncertainties inherent in such litigation, on June 25, 2013, the defendants entered into a Memorandum of Understanding (the Memorandum of Understanding) regarding the settlement of the State Action and the Federal Actions. The Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release all claims which were or could have been asserted in the State Action and the Federal Actions. In consideration for such settlement and release, the parties to the State Action and the Federal Actions agreed that OfficeMax and Office Depot would make certain supplemental disclosures to the joint proxy statement/prospectus, which OfficeMax made in a Current Report on Form 8-K filed with the SEC on June 27,

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2013. The Memorandum of Understanding contemplates that the parties will attempt in good faith to agree promptly upon a stipulation of settlement to be submitted to the State Court for approval at the earliest practicable time. The stipulation of settlement will be subject to customary conditions, including approval by the State Court, which will consider the fairness, reasonableness and adequacy of such settlement. The stipulation of settlement will provide that OfficeMax (or its successors in interest) will pay, on behalf of all defendants, the plaintiffs attorneys fees and expenses, subject to approval by the State Court, in the amount of \$735,000, following dismissal of both the State Action and the Federal Actions with prejudice. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the State Court will approve the settlement even if the parties were to enter into such stipulation. In such event, or if the transactions contemplated by the Merger Agreement are not consummated for any reason, the proposed settlement will be null and void and of no force and effect.

**ITEM 1A. RISK FACTORS**

For information regarding risk factors, see Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 29, 2012. There have been no material changes to the Company's risk factors during the first nine months of 2013, except as previously reported in Item 1A. Risk Factors in our quarterly report on Form 10-Q for the quarter ended March 30, 2013.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Information concerning our stock repurchases during the three months ended September 28, 2013 is below. All stock was withheld to satisfy tax withholding obligations upon vesting of restricted stock awards.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid Per Common Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
June 30 - July 27, 2013		\$		
July 28 - August 24, 2013	6,561	11.41		
August 25 - September 28, 2013				
Total	6,561	\$ 11.41		

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

Required exhibits are listed in the Index to Exhibits and are incorporated by reference.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OFFICEMAX INCORPORATED

/s/ DEBORAH A. O CONNOR  
**Deborah A. O Connor**

*Senior Vice President, Interim Chief Financial Officer and  
Chief Accounting Officer*

*(As Duly Authorized Officer and Principal*

*Financial Officer)*

Date: November 5, 2013

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**OFFICEMAX INCORPORATED**

**INDEX TO EXHIBITS**

Filed with the Quarterly Report on Form 10-Q for the Quarter Ended September 28, 2013

<b>Exhibit</b>	
<b>Number</b>	<b>Exhibit Description</b>
3.1(1)	Conformed Restated Certificate of Incorporation, reflecting all amendments to date.
3.2(2)	Amended and Restated Bylaws, as amended February 12, 2009.
10.1(3)	Form of Retention Bonus Agreement.
31.1*	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32**	Section 906 Certifications of Chief Executive Officer and Chief Financial Officer of OfficeMax Incorporated
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

\* Filed with this Form 10-Q.

\*\* Furnished with this Form 10-Q.

- (1) Exhibit 3.1 was filed under the exhibit 3.1.1 in our Registration Statement on Form S-1 dated November 4, 2009, and is incorporated herein by reference.
- (2) Exhibit 3.2 was filed under the exhibit 3.2 in our Current Report on Form 8-K dated February 18, 2009, and is incorporated herein by reference.
- (3) Exhibit 10.1 was filed under exhibit 99.1 in our Current Report on Form 8-K dated July 29, 2013, and is incorporated herein by reference.

f">arterial thrombosis

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**Line Extensions**

*Atacand* angiotensin II antagonist CHF outcomes (CHARM study)      Approved Filed

diabetic retinopathy >2007 >2007

*Crestor* statin atheroma 2H 2006 2H 2006

outcomes CHF >2007 >2007

outcomes renal 2007 2007

*Seloken/Toprol-XL* beta blocker HCTZ combination 3Q 2005

*Exanta* thrombin inhibitor prevention of stroke in AF      Filed Filed\*

treatment of VTE      Filed >2007

arterial/post MI      >2007 >2007









Nexium proton pump inhibitor NSAID GI side effects symptom resolution Promotable\* Filed

parenteral formulation Launched Filed

NSAID GI side effects ulcer prevention Launched Launched

NSAID GI side effects ulcer healing Launched Filed

extra-oesophageal reflux disease >2007 >2007 \*Authorities stated these symptoms were already captured within the GERD label.  
Text stating No clinical interaction with naproxen or rofecoxib was approved. **Infection**

**Line Extensions**

infections

Filed

*Merrem* carbapenem antibiotic skin and soft tissue

**Neuroscience**

**NCEs**











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bipolar depression      2007 1H 2006

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Compound	Mechanism	Areas under investigation	Phase				Estimated filing date	
			PC	1	2	3	MAA	NDA
<b>Oncology</b>								
<b>NCEs</b>								
<i>Iressa</i>	EGFR-TKI	NSCLC					Withdrawn	Launched
ZD6474	angiogenesis inhibitor (VEGFR-TKI)	solid tumours					>2007	>2007
ZD4054	endothelin A receptor antagonist	solid tumours					>2007	>2007
AZD2171	angiogenesis inhibitor (VEGFR-TKI)	solid tumours					>2007	>2007
AZD3409	farnesyl-transferase inhibitor	solid tumours					>2007	>2007
AZD0530	SRC kinase inhibitor	solid tumours and haematological malignancies					>2007	>2007
AZD5438	selective cyclin dependent kinase inhibitor	solid tumours					>2007	>2007
AZD6244	MEK inhibitor	solid tumours					>2007	>2007
ZD6126	vascular targeting agent	solid tumours					>2007	>2007
AZD4440	vascular targeting agent	solid tumours					>2007	>2007
AZD9935	angiogenesis inhibitor (VEGFR-TKI)	solid tumours					>2007	>2007
AZD0424	SRC kinase inhibitor	solid tumours					>2007	>2007
AZD1152	aurora kinase inhibitor	solid tumours and haematological malignancies					>2007	>2007
AZD4769		solid tumours					>2007	>2007
AZD3841		solid tumours					>2007	>2007
AZD8931		solid tumours					>2007	>2007


















## Line Extensions

<i>Faslodex</i>	oestrogen receptor antagonist	1st line advanced breast cancer		>2007	>2007
<i>Iressa</i>	EGFR-TKI	head and neck cancer*		2H 2006	2H 2006
		breast cancer*		>2007	>2007
		colorectal cancer*		>2007	>2007

\* Under review













## Respiratory and Inflammation

## NCEs

AZD9056	ion channel blocker	rheumatoid arthritis		>2007	>2007
AZD9056	ion channel blocker	osteoarthritis		>2007	>2007
AZD8309	chemokine receptor antagonist	rheumatoid arthritis		>2007	>2007
AZD8955	collagenase inhibitor	osteoarthritis		>2007	>2007
AZD8309	chemokine receptor antagonist	COPD		>2007	>2007
AZD3778	chemokine receptor antagonist	asthma/rhinitis		>2007	>2007
AZD9056	ion channel blocker	COPD		>2007	>2007
AZD3342	protease inhibitor	COPD		>2007	>2007
AZD6067	protease inhibitor	COPD		>2007	>2007
AZD2098		asthma		>2007	>2007
AZD1981		asthma		>2007	>2007
AZD0902	ion channel blocker	rheumatoid arthritis		>2007	>2007
AZD6703		rheumatoid arthritis		>2007	>2007
AZD6357		osteoarthritis		>2007	>2007
AZD7928		COPD		>2007	>2007
AZD2914		COPD		>2007	>2007
AZD2392		asthma/rhinitis		>2007	>2007

AZD1744	asthma/rhinitis		>2007	>2007
AZD5672	rheumatoid arthritis		>2007	>2007

**Line Extensions**

<i>Symbicort Turbuhaler</i>	inhaled steroid/fast onset, long-acting beta <sub>2</sub> agonist	single therapy for asthma	   	2H 2005
<i>Symbicort pMDI</i>	inhaled steroid/fast onset, long-acting beta <sub>2</sub> agonist	asthma	   	Filed 2Q/3Q 2005*
		COPD	   	Filed 2007

\* The FDA has identified some issues associated with the inhaler that require the generation of additional chemistry and manufacturing data or possible modification of the device in order to achieve approval.

**Comments** As disclosure of compound information is balanced by the business need to maintain confidentiality, information in relation to some compounds listed here has not been disclosed at this time.

Compounds in development are displayed by phase.

**Abbreviations:**

**5HT** – 5-hydroxytryptamine (serotonin)

**5HT<sub>1B</sub>** – 1B subtype of 5HT receptor

**5HT<sub>2</sub>** – 2 subtype of 5HT receptor

**ADP** – adenosine diphosphate

**AF** – atrial fibrillation

**CHF** – congestive heart failure

**COPD** – chronic obstructive pulmonary disease

**CPU** – carboxy peptidase-U

**D<sub>2</sub>** – 2 subtype of dopamine receptor

**EGFR-TKI** – epidermal growth factor receptor-tyrosine kinase inhibitor

**GERD** – gastro-oesophageal reflux disease

**GI** – gastrointestinal

**H** – half year

**HCTZ** – hydrochlorothiazide

**IBAT** – ilial bile acid transport

**IV** – intravenous

**MAA** – marketing authorisation application (Europe)

**MEK** – mitogen activated (extra-cellular signal-regulated kinase) kinase

**MI** – myocardial infarction

**NCE** – new chemical entity

**NDA** – new drug application (US)

**NMDA** – N-methyl-D-aspartate

**NSAID** – non-steroidal anti-inflammatory drug

**NSCLC** – non-small cell lung cancer

**P-CAB** – potassium-competitive acid blocker

**PC** – pre-clinical: candidate drug accepted for development but not yet administered to man

**pMDI** – pressurised metered dose inhaler

**PPAR** – peroxisome proliferator-activated receptor

**Q** – quarter

**sc** – subcutaneous

**TLESR** – transient lower oesophageal sphincter relaxations

**VEGFR-TKI** – vascular endothelial cell growth factor receptor-tyrosine kinase inhibitor  
**VTE** – venous thromboembolism  
**>2007** – not earlier than 2008

**Discontinued projects:**

**AZD4750** – multiple sclerosis

**AZD5455** – anxiety

**AZD0328** – Alzheimer's disease

**Seroquel** – granules

**AZD2858** – Alzheimer's disease

**ZD0947** – overactive bladder

**AZD0902** – COPD

**AZD0303** – thrombosis

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Operational Review

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## Research and Development (R&D)

R&D continues to focus on improving the productivity and efficiency of new drug discovery and development. We are simplifying our processes and continually review our plans and decision-making. We have streamlined portfolio reviews and target our strategic investment on areas directly linked to increased quality and output of new products.

In Discovery, we aim to increase the output of high quality candidate drugs (CDs) with a lower risk of failure in development. In Development, we aim to develop better drugs faster.

The consequences of the strong drive to increase productivity are becoming evident in the size of the early development portfolio. During 2004, 18 CDs were selected (15 in 2003 and 11 in 2002). At the end of 2004, there were 31 projects in the pre-clinical phase and 17, 17 and 25 projects in clinical phases 1, 2 and 3 respectively.

AstraZeneca employs around 11,900 people in R&D. We have six major joint discovery and development facilities in the UK, the US and Sweden; a further four sites in the US, Canada, India and France, which focus only on discovery, and a facility in Japan for development only. These resources are complemented by clinical development at 43 sites around the world. In 2004, our R&D investment totalled \$3.8 billion.

R&D remains an integrated, project-driven organisation. Our approach is therapy arealed with scientific, medical, technical and ethical input and control being provided by large, multi-skilled Discovery and Development organisations. This offers a number of advantages including sharing of best practice in terms of science and technology and efficient use of resources across a multi-site, global organisation.

Global knowledge expertise is recognised as a key competitive advantage for AstraZeneca. An R&D information and knowledge management initiative has introduced a knowledge sharing system, initially directed towards supporting our global R&D staff and their internal partners.

We remain focused on meeting our objectives of delivering new, medically important and commercially successful products to the market every year.

### Discovery

In Discovery our highly skilled scientists work together across boundaries to exchange ideas, to promote best practice and to maximise the opportunities that are offered by our size and global reach. We focus on finding novel medicines for targeted unmet medical needs. This is supported by other specialised Discovery groups in Safety Assessment, Process R&D and Global Science & Information who also support the projects in their progress through Development and lifecycle management.

Our core priority is to support increased productivity in R&D. This includes improving the quality of biological targets and chemical leads, so that we can expect reduced later stage clinical product attrition. Discovery-Medicine (the partnership between clinical medicine and basic science) is embedded in the organisation. There are many examples where this initiative has helped us gain a better understanding of human diseases and the suitability of future drugs to prevent and treat those diseases. We also continue to introduce, earlier in the process, more stringent and, where possible, high throughput testing of safety and drug metabolism/pharmacokinetics, so that CDs chosen for development are more likely to succeed.

Our Global Science & Information group supports all research areas with skills in compound management, structural chemistry, bio-imaging, transgenics, protein science and information science and informatics.

We continue to invest in R&D facilities. New or upgraded laboratory facilities were opened in 2004 in Sweden, the UK and the US. Ongoing training and development of our highly skilled employees continue.

## Development

People in our Development organisation specialise in clinical research, regulatory affairs and pharmaceutical development. They work globally in therapy area-led product teams that bring together all the relevant functional skills and experience needed for the robust, rapid progress of new medicines and the management of development risks.

Our focus in 2004 was to progress regulatory filings for *Exanta*, to support the continued launches of *Crestor* and *Iressa*, and to make regulatory submissions for new uses that broaden the claims or

geographic coverage of *Nexium*, *Symbicort* and *Atacand*. In 2004, the phase 3 programmes for *Cerovive* and *Galida* have continued to progress as planned. Progression of the early development portfolio has resulted in six projects achieving positive proof of principle in clinical studies during 2004.

To enhance productivity during 2004, we continued to focus on simplifying the processes for delivery of clinical trial data while maintaining the flexibility of a global organisation. A new clinical organisational structure was announced in October 2004 to support implementation of these new working practices. We have also continued to progress the operation of e-based clinical and regulatory systems that significantly increase the speed of access to data worldwide and reduce regulatory file preparation and submission timelines. In January 2005, following a year where there have been a number of disappointments, a new Executive Director was appointed with responsibility for Development as part of an accelerated significant programme of change to review our pipeline and optimise the contribution of our Development and Regulatory functions.

## Collaborations

To complement our in-house R&D capabilities, over 250 new collaborations have been entered into in 2004 with leading academic centres and biotechnology companies, bringing the total number of active R&D collaborations and agreements to more than 1,700.

We entered into a strategic alliance with Cambridge Antibody Technology (CAT) with the aim of discovering and developing human antibody therapeutics in inflammatory disorders. The five year collaboration includes a minimum of 25 programmes to be initiated in the discovery phase and following the completion of the phase, CAT and AstraZeneca may each elect to continue funding programmes into development.

Other examples of external collaborations include those with Abgenix Inc., Sumitomo Pharmaceuticals Co. Ltd., NeoGenesis Pharmaceuticals, Inc., Cytokinetics, Inc., Biosignal Inc., Array Biopharma Inc., Astex Technology Ltd, BG Medicine (Beyond Genomics Inc.), Dyax Corp., Shanghai Jiaotong University, Procardis, Griffith University, the University of Dundee and Institut Curie.

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## Commercialisation and Portfolio Management

AstraZeneca continues to have one of the most competitive portfolios of marketed products in the pharmaceutical industry. Maintaining the quality of this portfolio and of our development pipeline of new products requires careful prioritisation both to manage the progression of promising compounds from development to market place and to maximise the value of high potential marketed products. We are committed to organic growth, but in common with other leading pharmaceutical companies, our licensing activities seek to bring in new products and/or technologies and to support growth products in a cost-effective manner.

Product Strategy & Licensing (PS&L), while working closely with R&D and our major marketing companies, leads the commercial aspects of drug development and co-ordinates global market strategy. This includes selecting the right products and projects for investment, developing effective marketing platforms in time for new product launches and directing the creation and delivery of product marketing strategies that successfully align global and national plans.

To ensure the success of our medicines, we aim to address unmet medical needs, find novel solutions, minimise technical risk and maximise commercial opportunity. We have clearly defined lifecycle management programmes for all our products, which maximise not just the commercial potential of the brands, but also the value they bring to patients' lives. In addition, our customer base has broadened over the past year and our marketing programmes have widened accordingly to take account of every aspect of building global brands. This includes working with, among others, patient advocacy groups, caregivers, opinion leaders and pharmacists.

Target product profiles (TPPs) for each new product are clearly defined at a very early stage in Discovery in order to set parameters for R&D activity and to help shape the marketing strategy. The profile is based on our insight into the needs in the market place and the drivers behind recommending, prescribing, paying for and taking the medication. Among the factors considered in developing a TPP are product features and benefits, medical and health outcomes information, market positioning, demonstration of value and the competitive environment. At each major stage in

development, the product is tested against this target profile and is only prioritised for further investment if it meets or exceeds the target.

Where appropriate, we exploit internet strategy and marketing technologies to facilitate and enhance our commercial activities. Growing numbers of doctors and patients actively seek information from us via the internet and, where allowed, we are able to share knowledge, best practice and expertise via this channel.

Direct and timely communication via the internet facilitates some of the important goals for the organisation such as supporting our sales efforts; augmenting our brands; maintaining and building longer term relationships; and ensuring appropriate use of our products. Internet services continue to grow in diversity and value to our customer groups, requiring us to monitor and evaluate new techniques and technology to achieve our business objectives and ensure ongoing competitiveness. AstraZeneca is recognised as one of the industry leaders for online marketing and communication to customers.

We have undertaken a number of consumer initiatives to increase disease awareness and fully recognise the importance of patients and patient groups in making healthcare choices across the globe. Drug and disease physician and patient education modules developed across our therapy areas have been deployed internally and externally to great effect and we continue to seek to leverage these resources across a wider group of stakeholders, particularly where first-in-class products are reaching our markets and demand for such education is high.

Internet-enabled processes have brought efficiency and effectiveness gains across R&D and commercial activities, facilitating the rapid sharing and distribution of information within and outside the organisation. Additionally, a number of internet-enabled sourcing projects are enhancing our purchasing practices and delivering clear, measurable value.



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As part of our commitment to exploring all the ways in which we can bring benefit to patients, we are expanding our thinking beyond medicines to include a focus on ways in which we can help them get access

to the information and services they need. This includes IT collaborations that will aim to deliver innovative channels for providing patients with information about their treatment and/or their disease. Through closer partnership with patients, we aim to build our understanding of their needs and how we can best respond.

Our products are marketed primarily to physicians (both general and specialist) as well as to other healthcare professionals. Marketing efforts are also directed towards explaining the value and the therapeutic benefits of our products to governments and healthcare buying groups, for example, managed care organisations in the US, trust hospitals and budget-holding medical groups in the UK and other organisations which pay for healthcare costs in various countries. In the US, we invest a significant amount of money in direct-to-consumer (DTC) advertising campaigns for certain of our products (notably *Nexium* and *Crestor*). These DTC efforts are part of a comprehensive and, we believe, valuable campaign to educate consumers about certain conditions and potential treatment options. Research among physicians supports our view that DTC advertising provides this educational value to consumers.

AstraZeneca's principal competitors are other international, research-based pharmaceutical and biotechnology companies which also sell branded, patent-protected, prescription pharmaceuticals.

Following patent expiry, our products also compete with generic pharmaceuticals. Competition with generic pharmaceuticals is principally on price since generic pharmaceutical companies typically incur only limited R&D costs compared to those of research-based companies such as AstraZeneca.

Our ability to maintain and enhance our competitive position in our chosen therapy areas depends mainly on our development of new, innovative, cost-effective products from our R&D and in-licensing activities, the manufacture and supply of products to high quality standards and the effective marketing of products to our global customer groups.

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## Supply and Manufacturing

With 30 manufacturing sites in 20 countries and around 15,000 employees worldwide, our Operations organisation provides secure, high quality, cost-effective supply of AstraZeneca's product range globally. We measure our performance using four key metrics: customer service, supply capability, cost efficiency and licence to operate.

### Customer service

The fast and effective introduction of new products is key to success. Our supply chains are designed to maximise flexibility. For example, the global roll-out of *Crestor* continued, European *Exanta* launches were supported, and all major markets completed the launch of *Zoladex Safesystem* which is designed to protect against needlestick injuries when handling the injectable *Zoladex* therapy. With a few temporary exceptions, major products and line extensions were successfully supported with supplies available to meet market demand.

### Supply capability

Our strategy remains to operate a small number of sites for the manufacture of active ingredients and combine it with effective use of outsourcing. AstraZeneca has active ingredient sites in the UK, Puerto Rico, Sweden and France and a bulk drug purification plant in Germany. Around 1,600 people are employed in active pharmaceutical ingredient supply.

Principal formulation sites for tablets and capsules are in six countries - the UK, Sweden, Puerto Rico, France, Germany and the US. There are also major formulation sites for the global supply of parenteral and inhalation

in 2004. New plant authorised included formulation capacity for *Symbicort* in France, for *Pulmicort* in the US and for *Nexium* and *Seloken/Toprol-XL* in Sweden.

AstraZeneca's global purchasing policies and processes together with our business interruption risk management (BIRM) process are aimed at ensuring the supply of raw materials and other key supplies, all of which are purchased from a range of suppliers. The BIRM process systematically examines a range of risk scenarios to global supply, such as disasters that remove supply capability or the unavailability of key raw materials and ensures that these risks are mitigated by the implementation of contingency plans, including the appropriate use of dual or multiple suppliers and maintenance of appropriate stock levels. Although the price of raw materials may fluctuate from time to time, our global purchasing policies seek to avoid such fluctuations becoming material in our business.

### Cost efficiency

2004 saw the continued implementation of our new supply system which has demonstrated progressive benefits, with higher customer service levels, reduced manufacturing lead times and consequently reduced requirements for the build up of stock. The programme has now been substantially implemented throughout the supply network. In 2004, improvements in stock levels on mature products were partly offset by stock increases on launched products with exchange movements also increasing the

view to focusing stock reductions to improve working capital utilisation.

The introduction of new purchasing category management proceeded throughout 2004 in key areas of spend to maximise value from external expenditure, and implementation will continue in 2005.

### Licence to operate

We are committed to delivering a secure basis for assured product quality that ensures both the safety and efficacy of our medicines. As part of this, the outcomes of routine internal inspections as well as those by regulatory authorities are rigorously reviewed and, if required, actions are taken to further enhance compliance. Device presentations of inhalation products present manufacturing challenges and where appropriate, like other manufacturers, we keep these under review with relevant regulators. The results of all external inspections carried out during 2004 were satisfactory and we did not experience any delays to approvals due to regulatory compliance issues at our sites or those of our contractors.

Safety, health and environment (SHE) operating standards are increasingly stringent with regulators placing particular emphasis on environmental issues and the safety of chemicals. AstraZeneca's manufacturing sites operate under various regulatory and licensing regimes and we are focused on meeting all regulatory requirements and current good practice standards. There are currently no environmental issues that constrain AstraZeneca from fully utilising any sites. The Company continues to track, participate actively in, and pursue internal initiatives

products in Sweden, France and the UK. Packaging is undertaken at a large number of locations, both at AstraZeneca sites and at contractors facilities, located close to our marketing companies to ensure rapid and responsive product supply. Around 12,400 people are employed in formulation and packaging.

Process improvements, additional capacity investments and the effective use of external contractors ensure the secure and effective supply of our products. As part of our overall risk management, we carefully consider the timing of investment to ensure that secure supply chains are in place for our products.

Capital expenditure on supply and manufacturing facilities totalled \$352 million

financially reported figures.

Cost efficiencies are also driven by continuous review of our manufacturing assets to make sure that they are being used most effectively, whilst preserving the flexibility we need to respond to fluctuations in demand. Our facility in Karlskoga (Sweden) was sold during 2004 and we will continue to make further adjustments to our manufacturing base to ensure optimum utilisation of production facilities.

The new supply system has also increased the focus on managing costs throughout the product lifecycle. Product supply chains are being modelled with a view to targeting cost of goods reductions through improving yields, undertaking process changes and adjusting buying patterns to reduce material costs. Stock levels and stock turns are also being modelled for major products with a

relating to, international research and policy developments associated with emerging environmental, health and safety policy matters such as pharmaceuticals in the environment, chemical control regulations and global climate change. It is possible that we could incur capital or operational costs in connection with future voluntary activities or regulatory developments relating to these issues including, for example, process or equipment changes associated with wastewater quality, raw material substitutions, green chemistry initiatives or energy efficiency. We are addressing these matters proactively and they are not expected to have a material impact on the Company's competitive or financial position.

## Main Facilities

We are making steady progress against our targets for the reduction of waste and energy usage and the overall level of accidents with injury is falling. However, sadly an employee died in an accident at one of our manufacturing locations during the year. When any accidents occur, we use a range of investigation procedures to help us understand the causes and avoid repetition. Our aim for continuous improvement includes learning from incidences of non-compliance and sharing best practice to further promote high standards.

Further information and statistics about our SHE performance can be found in the separate Corporate Responsibility Summary Report 2004 or on our website: [astrazeneca.com](http://astrazeneca.com).

AstraZeneca owns and operates numerous production, marketing and R&D facilities worldwide. Our corporate headquarters are in London, UK and our R&D headquarters are in Södertälje, Sweden.

Our principal R&D facilities are in the UK (Alderley Park and Charnwood); Sweden (Lund, Mölndal and Södertälje); the US (Boston, Massachusetts and Wilmington, Delaware); Canada (Montreal, Quebec); and India (Bangalore). Other R&D activity is carried out at Macclesfield and Avlon in the UK, Reims in France and Osaka in Japan.

Out of a total of 30 manufacturing sites in 20 countries, our principal manufacturing facilities are in the UK (Avlon and Macclesfield); Sweden (Snäckviken and Gartuna, Södertälje); the US (Newark, Delaware and Westborough, Massachusetts); Australia (North Ryde, New South Wales); France (Dunkirk, Monts and Reims); Germany (Plankstadt and Wedel); Italy (Caponago); Japan (Maihara) and Puerto Rico (Canovanas, Guayama and Carolina).

Bulk drug production is concentrated in the UK, Sweden, France and Puerto Rico.

Substantially all of our properties are held freehold, free of material encumbrances and we believe such properties are adequate for their purposes.

## Other Businesses

### Astra Tech

Astra Tech is engaged in the R&D, manufacture and marketing of medical devices and implants for use in healthcare, primarily in urology and odontology, as well as in surgery and diagnostic radiology. Astra Tech has a leading position in several countries in Europe and is expanding its operations in key markets, particularly in the US.

All products showed good sales growth, in particular the Dental Implant System, which is gaining market share in several key markets. Further investments have been made in R&D, clinical research and new production facilities to strengthen the product portfolio and, in the US, in sales and marketing.

### Salick Health Care

Salick Health Care (SHC) is a leading provider of outpatient oncology management and consulting services. Ownership of SHC provides AstraZeneca with a unique window on the provider sector of the US oncology market and access to many opinion leaders in the field of oncology.

SHC manages full-service outpatient comprehensive cancer centres in affiliation with major teaching and community hospitals in California, Florida and New York and is affiliated with a large network of over 160 physicians, working in specialised areas such as haematology and medical, radiation and surgical oncology.

In 2004, SHC continued to perform well in its cancer centre management business with positive profit and cash contributions. We implemented a long term management agreement with

NYU Hospitals Center with the opening of a new 85,000 square foot cancer centre in Manhattan in July 2004. Focused on growth, SHC is actively pursuing consulting and management relationships in new markets in the US as well as exploring opportunities to bring its unique model of cancer care to the UK.

SHC also continued the development of its innovative clinical research network to improve patient care and cancer treatment. The SHC Research Network is conducting a growing number of centrally co-ordinated phase 2 and 3 clinical trials.

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## Corporate Responsibility (CR)

The trust and confidence of all our stakeholders, together with our reputation, are among our most valuable assets. Along with our commitment to competitiveness and performance, we will continue to be led by our core values to achieve sustainable success.

### Management

Good corporate responsibility depends on the right level of commitment from all employees, led by the AstraZeneca Board and Senior Executive Team, who approve the strategic direction, and our senior management, who are accountable for the development and implementation of appropriate programmes in their areas of responsibility. Based on the global CR policy, local implementation programmes are required to take account of regional, site or functional priorities and objectives. Individually, everyone at AstraZeneca has a responsibility to integrate CR considerations into their day-to-day decision-making, actions and behaviours.

The common platform that supports this effort worldwide includes our Group CR Policy, Group CR Standards and Global CR Priority Action Plan, which together provide the framework for understanding and managing the challenges and opportunities associated with our responsibility.

We are making progress, but there is more work to do to ensure that CR is consistently embedded throughout the organisation and actively interpreted and managed at a local level. An important step forward has been the creation of national CR committees in the US, the UK and Sweden where more than 60% of our employees are

We have also begun to integrate CR into our leadership development programmes and during the year we launched an intranet site dedicated to providing managers with the tools and guidance they need to put CR into practice at a local level.

### Evaluating performance

We have for some time had processes in place for monitoring our economic, environmental, safety and health performance. More recently, we have been focusing on developing key performance indicators (KPIs) in other areas of social responsibility. During 2004, we established new KPIs for animal use and welfare, and for marketing and sales practices, which will be introduced in 2005 to promote a consistent approach to monitoring performance globally. We continue to explore the ways in which we can meaningfully benchmark our performance in the area of social responsibility.

### Corporate governance

An essential part of our corporate responsibility is to continue to operate to high standards of corporate governance. Auditing compliance is a fundamental part of this. Our Group Internal Audit function (GIA) works to review, among other things, compliance with laws, regulations and Group policies. During 2004, 42 of our GIA audits focused on marketing and sales practice. Such audits are an effective tool in helping to drive consistent standards of practice worldwide.

Alongside the work of GIA, we continue to build on the experience of our long-standing SHE audit programme to include aspects of CR

### Product donations and patient assistance programmes

Our product donations and patient assistance programmes make products available free of charge or at reduced prices. In 2004, our commitment in this area totalled \$870 million valued at average wholesale price.

### Community support

We aim to make a positive contribution to our local communities through charitable donations and sponsorships that help to make a difference. In particular, we make contributions that are consistent with our business of improving health and quality of life and which promote the value of science among young people. In 2004, our spend on community support totalled \$20.7 million, including charitable donations of over \$5 million excluding the \$2.1 million tsunami disaster relief support.

More information about our commitment to CR, our priority action areas and our 2004 performance in these areas is available in the separate Corporate Responsibility Summary Report 2004 and on our website: [astrazeneca.com/responsibility](http://astrazeneca.com/responsibility).

located. National CR action plans, including local priorities and objectives are now in place in these three cornerstones of our global presence.

Another significant move was our decision in 2004 to formally integrate CR into the personal targets and performance reviews of all employees, including AstraZeneca's Senior Executive Team and senior management. This will further support the integration of CR considerations into business strategy development and everyday business thinking.

not previously covered elsewhere. Our rolling programme of site audits included 24 in 2004, all of which covered CR.

#### **Priority action planning**

Stakeholder expectations are constantly evolving and we review annually our Global Priority Action Plan to ensure that it continues to address the issues relating to our business that affect or concern society. We use internal risk assessment, external benchmarking and stakeholder dialogue to inform our thinking on what needs to be included in the Plan. In 2004, we added Clinical Trials and Pharmaceuticals in the Environment to the Plan.

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## Industry Regulation

Our products are subject to numerous regulations concerning their safety and efficacy. In many cases, governments also fix their price and/or restrict access to reimbursement. The degree and scope of regulation varies according to the product and countries concerned. Regulations governing prescription pharmaceuticals are stringent and manufacture and marketing are normally conditional upon regulatory approval. Registration processes are complex and time-consuming and involve significant expenditure. Regulation is concerned not only with a product's chemical composition, but also with matters such as manufacturing, handling, packaging, labelling, distribution, promotion and marketing.

AstraZeneca routinely participates in various industry associations and other bodies which, among other things, seek to ensure that those implementing legislation and regulations affecting pharmaceutical companies are fully informed as to their impact.

### Product regulation

Before a pharmaceutical product is approved for marketing, it must undergo exhaustive and lengthy clinical trials. The process of developing a new pharmaceutical product, from discovery to launch in the market, can take up to 12 years, but this period varies considerably in different cases and countries. The time taken from submission of an application for marketing approval to launch of the product is typically one to two years.

After a product has been approved and launched, it is a condition of the product licence that all aspects relating to its safety, efficacy and quality must be kept under review. Depending on the country, fines and other penalties may be imposed for failure to adhere to the conditions of product licences. In extreme cases, the product licence may be revoked resulting in withdrawal of the product from sale. Promotional and marketing activities are also tightly controlled by regulations and self-regulating codes of ethical marketing practices.

During the marketing of a product, strict procedures must be in place to monitor, evaluate and report any potential adverse reactions. Where adverse reactions occur or it is judged that they may occur, changes may be required to prescribing advice and

to the product licences. In extreme cases, the product licence may be revoked resulting in withdrawal of the product from sale.

Manufacturing plants and processes are subject to periodic external inspection by regulators as part of their monitoring procedures to ensure that manufacturers are complying with prescribed standards of operation.

### Price regulation

Prescription medicines are subject to government controls on price and reimbursement which operate in most countries in which we sell our products. This can result in large price differentials between markets, which may be further aggravated by currency fluctuations.

### US

Currently, there is no direct government control of prices for non-government drug sales in the US. Federal legislation mandates minimum discounts to US government agencies purchasing drugs for the active military, military veterans and other selected populations. Providing these substantial discounts to the US government is also a condition for the manufacturers' drugs to be reimbursed by state Medicaid programmes and an additional rebate is required if manufacturer price increases after 1990 exceed the increase in inflation.

In addition, certain states have taken action to require additional manufacturer rebates on Medicaid drug utilisation for the indigent population. State Medicaid programmes will continue to be a challenge to the market in the US. Innovative partnering opportunities have been established with select key states for several years, and new opportunities continue to be pursued, as appropriate. However, this becomes more difficult with each passing year.



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The Medicare Prescription Drug, Improvement, and Modernisation Act of 2003 was signed into law in December 2003. The legislation makes drug discount cards available in 2004 and 2005. These will be replaced by a prescription drug benefit for Medicare beneficiaries in 2006. The Act also legalises importation of drugs from Canada if the US Secretary of Health and Human Services certifies that implementation will pose no additional safety risk and it will result in a significant reduction in cost to the American consumers. As with previous laws

with similar provisions, the US Secretary of Health and Human Services has not yet provided the required certification.

### Europe

Most governments in Europe control the price and reimbursement of medicines after taking into account the medical, financial and social impact of a product. This budget-based approach reflects increasing constraints in overall healthcare spending. Governments increasingly require more assurance of value in their expenditures on medicines.

In several European countries, the pricing and reimbursement systems are being reviewed, with the aim of controlling and limiting drug budgets. This is an ongoing process that puts a downward pressure on pricing and reimbursement of medicines in Europe. One example of this is the increasing focus on, and support of generic versions of branded drugs, as seen in a number of countries such as France and Spain.

In Germany, so-called jumbo groups were introduced in support of a general aim to reduce spending on drugs, by calculating new and lower reimbursement price levels. These groups are formed around drug classes such as statins and PPIs. In the statin group, which includes branded as well as generic products, this has led to significant decreases in reimbursement levels for branded drugs, as the reference price levels that determine reimbursement have dropped.

### Japan

There is formal central government control of prices in Japan. New product prices are determined primarily by comparison with existing product classes. All existing products are subject to a price review based on the market price at least every two years. In addition, products with generic competition are forced to further reduce prices by 4-6%. Regulations also include an overseas price referencing system, under which prices can be adjusted according to the average price of four major countries (the US, the UK, Germany and France). Generally, if the US pricing environment remains unchanged, these regulations are likely to have a positive impact on pharmaceutical prices in Japan.

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## Intellectual Property

### Product regulation: Astra Tech

Product registration and certified quality management systems form the basis of the regulatory environment relating to medical devices. In Europe, compliance with regulatory requirements involves the implementation and maintenance of a quality management system and, for certain products, a design dossier review. Medical devices in the US are regulated through a product registration requirement. Astra Tech continues to maintain a European and US compliant quality management system.

### Product regulation: Salick Health Care (SHC)

The healthcare facilities to which SHC provides administrative and management services on behalf of certain hospitals are subject to extensive US federal, state and local legislation and regulations, such as those relating to the reimbursement and control of healthcare costs. The largest single component of SHC revenue continues to be fees that are affected by the reimbursement rates for healthcare services, which are set or regulated by federal or state authorities.

During 2004, AstraZeneca invested \$3.8 billion in R&D activities. Obtaining adequate protection for the intellectual property associated with these activities continues to be a key business imperative. The range of protection includes patents, trade marks, design registrations, copyrights and internet domain name registrations.

Our policy is to apply for patent and/or other appropriate intellectual property protection for all of the inventions and innovations of significant commercial value, which arise from our drug discovery, development, manufacturing, marketing and other business activities. It is also our policy to apply for intellectual property protection for all inventions and innovations being created as a result of the investments in R&D throughout the AstraZeneca organisation.

This policy is designed to provide each of our new products with an effective portfolio of valid, enforceable patent and other intellectual property rights in all significant markets to protect against unauthorised competition during commercialisation. This shield of intellectual property rights extends to those areas of target identification, genomics and other research technologies in which we invest significant resources. The adequacy of the patent, design, trade mark and domain name portfolio for individual products is kept under review during product development, clinical evaluation and marketing so that, wherever possible, additional protection may be sought for new applications and other developments. The therapy area focus of our R&D operating model allows appropriate intellectual property strategies to be formulated and regularly updated from an early stage in product development.

We vigorously defend our intellectual property rights, including taking appropriate infringement action in various courts throughout the world.

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## Financial Review

### Introduction

The purpose of the Financial Review, which should be read in conjunction with the Operational Review on pages 11 to 36, is to provide a balanced and comprehensive analysis, including the key business factors and trends, of the financial performance of the business during 2004, the financial position as at the end of the year and the main business factors and trends which could affect the future financial performance of the business.

The key sections of the Financial Review are:

- > Business background and major events affecting 2004.
- > Key performance indicators.
- > Results of operations – summary analysis of year to 31 December 2004.
- > Financial position, including cash flow and liquidity.
- > Capitalisation and shareholder return.
- > Financial risk management policies.
- > Future prospects.
- > Critical accounting policies and estimates.
- > Off-balance sheet transactions, contingent liabilities and commitments.
- > New accounting standards.
- > International accounting.
- > Sarbanes-Oxley Act section 404.

Additionally, in accordance with US requirements:

- > Results of operations – summary analysis of year to 31 December 2003.
- > US GAAP information 2002-2004.

### Business background and major events affecting 2004

The business background is covered in the Operational Review and Global Market Overview and describes in detail the developments in both our products and geographical regions. The following comments highlight how these and other factors affect our financial performance.

Our operations are focused on prescription pharmaceuticals and more than 97% of our sales are made in that sector. Sales of pharmaceutical products tend to be relatively insensitive to general economic circumstances in the short term. They are more directly influenced by medical needs and are generally financed by health insurance schemes or national healthcare budgets.

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

- > The risk of generic competition following loss of patent exclusivity or patent expiry with the potential adverse effects on sales volumes and prices.
- > The timings of new product launches which can be influenced by national regulators and the risk that such new products do not succeed as anticipated.
- > The rate of sales growth and costs following new product launches.
- > The adverse impact on pharmaceutical prices as a result of the regulatory environment. Although there is no direct governmental control on prices in the US, pressures from individual state programmes and health insurance bodies are leading to downward forces on realised prices. In other parts of the world, there are a variety of price and volume control mechanisms and retrospective rebates based on sales levels which are imposed by governments.
- > Currency fluctuations, which can significantly affect our results. Our functional and reporting currency is US dollars as this is our single largest currency, but we have substantial exposures to other currencies, in particular, significant euro and

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Japanese yen denominated income and sterling and Swedish krona denominated costs. Over the longer term, the success of our research and development is crucial. In common with other pharmaceutical companies we devote substantial resources to R&D, the benefit of which emerges over the long term and carries considerable uncertainty as to whether it will generate future products.

The business events which were the most significant for our financial results in 2004 are as follows:

- > Strong sales performances from our key growth products to \$11,161 million (52% of sales), particularly in the second half of the year.
- > Slowing rate of decline of patent expired products, again in the second half of the year.
- > Growth of *Crestor* sales to \$908 million, despite what we believe are unfounded allegations about safety.
- > Following a period of high investment in selling and marketing in support of *Nexium* and *Crestor* in the first half of 2004, we have reduced our cost growth rate significantly in the second half of the year.
- > The decision by the FDA not to approve *Exanta*, whilst not materially affecting sales in 2004, has led us to make provisions against product stocks, goodwill and other assets of \$151 million.
- > Similarly, the preliminary results of the ISEL study on *Iressa* reported in December 2004 have led to provisions against product stocks and manufacturing assets of \$85 million.
- > In the year, we disposed of our investment in the joint venture Advanta BV, realising an exceptional gain of \$219 million.

### Key performance indicators (KPIs)

The primary KPIs used by management to understand and manage the financial performance of the business include:

- > The analysis of sales growth with products allocated to three groups; growth , patent expiry and base which allow us to understand how the business is regenerating itself in the short term.
  - > Trends in prescription volumes which give insights into the underlying
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## Financial Review continued

	2004			2003	2004 compared to 2003	
	\$m	Growth underlying \$m	Growth due to exchange effects \$m	\$m	Growth underlying %	Growth reported %
Cardiovascular	4,777	653	214	3,910	17	22
Gastrointestinal	5,918	(278)	253	5,943	(4)	
Infection	539	33	30	476	7	13
Neuroscience	3,496	542	121	2,833	19	23
Oncology	3,376	437	196	2,743	16	23
Respiratory and Inflammation	2,583	176	146	2,261	8	14
Other pharma	177	10	15	152	7	17
Others	560	6	23	531	1	5
<b>Total</b>	<b>21,426</b>	<b>1,579</b>	<b>998</b>	<b>18,849</b>	<b>9</b>	<b>14</b>

	2004			2003	2004 compared to 2003	
	\$m	Growth underlying \$m	Growth due to exchange effects \$m	\$m	Growth underlying %	Growth reported %
Growth*	11,161	2,476	441	8,244	30	35
Patent expiry**	2,521	(889)	189	3,221	(28)	(22)
Base	7,744	(8)	368	7,384		5

<b>Total</b>	<b>21,426</b>	<b>1,579</b>	<b>998</b>	<b>18,849</b>	<b>9</b>	<b>14</b>
* <i>Atacand, Arimidex, Casodex, Crestor, Faslodex, Iressa, Nexium, Seroquel, Symbicort and Zomig</i> ** <i>Losec, Zestril and Nolvadex</i>						

business growth, as opposed to invoiced sales which depend on the timing of wholesaler demand.

- > Cost growth rates, through which we manage the cost base to ensure that it is growing appropriately in relation to sales.
- > Operating profit margin progression over time, which demonstrates the overall quality of the business.

Financial growth rates in sales, costs and operating profit, both in US dollar and percentage terms, are not referred to specifically in the Financial Statements but, as indicated above, we use them extensively as part of our KPIs and, accordingly, include them in our discussions in both the Operating and Financial Reviews. In particular, we calculate underlying growth using constant exchange rates (CER), which is defined as a non-GAAP measure because, unlike actual growth, it cannot be derived directly from the information in the Financial Statements. This measure removes the effects of currency movements to focus on the changes in product sales and expenses driven by volume, prices and cost levels

relative to the prior period. However, we recognise that CER growth should not be used in isolation and, accordingly, we also discuss the comparable GAAP actual growth measures which reflect all the factors that affect our business in the reported performance sections of this document. Underlying CER growth is calculated by retranslating the current year performance at the previous year's exchange rates and adjusting for other exchange effects, including hedging.

## Results of operations summary analysis of year to 31 December 2004

The tables on this page show our sales analysed both by therapy area and by growth/patent expiry/base products and operating profit for 2004 compared to 2003.

### Reported performance

Our sales increased by 14% compared to 2003, representing a rise of \$2,577 million from \$18,849 million to \$21,426 million. Operating profit increased by 16% from \$4,111 million to \$4,770 million.

### Underlying performance

#### Sales

After excluding the effects of exchange, underlying sales for the full year increased by 9%. Global sales of key growth products\* reached \$11,161 million for the full year (up 30%) and now comprise 52% of total sales (compared to 44% in 2003). Patent expiry products\*\* declined by 28%, recording sales in aggregate of \$2,521 million in 2004, 12% of our total sales (compared to 17% in 2003). Sales of base products remained constant, although the relative percentage of total sales fell from 39% in 2003 to 36% in 2004.

In the Gastrointestinal therapy area, *Nexium* sales reached \$3,883 million for the full year, up 15%. Sales in the US reached \$2,716 million on strong growth in dispensed tablet volume (up 20%). Pricing was broadly neutral in its impact for the full year; the reported 10% sales growth rate in the US for the full year was lower than underlying growth as a result of wholesaler stock reductions. Sales outside the US increased 29% to \$1,167 million.

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Operating profit (2004 and 2003)	2004			2003	2004 compared to 2003	
	\$m	Growth underlying \$m	Growth due to exchange effects \$m	\$m	Growth underlying %	Growth reported %
Sales	21,426	1,579	998	18,849	9	14
Cost of sales	(5,150)	(421)	(260)	(4,469)	(9)	(15)
Other operating costs	(11,821)	(651)	(709)	(10,469)	(6)	(13)
Other operating income	315	91	24	200	5	58
<b>Operating profit</b>	<b>4,770</b>	<b>598</b>	<b>53</b>	<b>4,111</b>	<b>15</b>	<b>16</b>

Sales of Cardiovascular products increased by 17% for the full year, chiefly on sales of *Crestor* which totalled \$908 million (including \$543 million in US sales). In the US, market share has been volatile, as a result of episodic media coverage of challenges to the *Crestor* safety profile, despite mounting evidence amassed from clinical trials experience and thorough analysis of post-marketing surveillance reports supporting our view that the safety profile of *Crestor* is in line with that of other marketed statins. In late November 2004, US Senate hearings related to Merck's *Vioxx* fuelled news reports on *Crestor* and four other products, which has interrupted market share progress. In the week ending 14 January 2005, *Crestor* share of new prescriptions was 6.0%. Market share in the dynamic segment (new and switch patients) was 8.2%. We are determined to restore market share momentum, as we have done previously. In addition, discussions with the FDA are ongoing to determine whether there is a realistic prospect of bringing *Exanta* to the US market following the FDA's decision in October 2004 not to approve the product.

Oncology sales enjoyed strong growth, with a notable performance from *Arimidex* (up 48%). The disappointing results from a preliminary analysis of the ISEL study into *Iressa* patients' survival had little impact outside the US on sales in 2004. In 2005 in the US, we anticipate a rapid reduction in new prescriptions and sales will be recognised on confirmed patient usage. While commercial prospects have certainly been reduced in Western markets, the positive results in patients of East Asian origin offer the prospect of a continuing successful business in these important markets.

Neuroscience also saw significant growth driven by *Seroquel* sales which increased by 33% to exceed \$2 billion for the first time.

*Symbicort* sales growth of 32% to \$797 million was the principal contributor to growth of 8% in Respiratory and Inflammation sales.

In the US, the Inventory Management Agreements (IMAs) entered into during 2004 have successfully reduced wholesaler stock volatility and by the end of the year wholesaler stocks were close to target levels. Over the year wholesaler stocks are estimated to have declined by around \$150 million. Adjusting both 2004 and 2003 for net wholesaler stock movements, it is estimated that total sales growth for 2004 would increase from 9% to 11%.

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We discuss the performances of the therapy areas and the individual products in those areas in more detail in the appropriate sections of the Operational Review.

### Geographical analysis

Underlying sales growth in the US was 10%. However, growth for the full year was estimated to be 15% when adjusted for net wholesaler stock movements in 2003 and 2004. Increased sales of *Crestor*, *Seroquel*, *Nexium* and *Arimidex* more than offset a further \$500 million decline in sales of *Prilosec* for the year.

Sales in Europe were up 3% for the full year, with increased volume partially offset by declining realised prices. The launch roll out for *Crestor* and good growth for *Nexium* (up 26%), *Symbicort* (up 29%), *Arimidex* (up 48%) and *Seroquel* (up 45%) more than offset declines in *Losec* (down 25%) and other mature products.

Sales in Japan were up 11% for the full year on strong performance in Oncology products (up 19%) and for *Losec* (up 24%).

We discuss the geographic performances in more detail in the appropriate sections of the Operational Review.

### Operating margin and retained profit

Gross margin decreased by 0.2 percentage points to 76.0% including a negative currency effect of 0.1 percentage points. Lower payments to Merck, amounting to 4.9% of sales for the year, benefited gross margin by 0.9 percentage points. The resulting underlying decline in gross margin of 1.1 percentage points is entirely attributable to the provisions and write-offs against *Exanta* (\$151 million) and *Iressa* assets (\$85 million).

R&D and SG&A combined grew by 6%, with R&D growing by 3% and SG&A by 8%. These growth rates have slowed considerably during the year as product launch cost growth, which commenced in the second half of 2003, has reached a plateau. This, together with continued strict cost control, has reduced R&D as a percentage of sales by 0.6 percentage points to 17.7% of sales while SG&A as a percentage of sales has slightly improved to 36.6% of sales (both movements excluding currency).

Other income benefited from the disposal of the Durascan business in the second quarter of the year and disposals of short term listed investments. Royalty income remained broadly unchanged.

Operating margin increased by 0.5 percentage points from 21.8% to 22.3%. Currency depressed operating margin by 0.9 percentage points implying an underlying margin improvement of 1.4 percentage points.

The disposal of the Advanta joint venture was completed on 1 September 2004 for net cash of \$284 million. All payments due have now been received. The profit on disposal, after transaction costs and warranty and indemnity provisions, was \$219 million.

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## Financial Review continued

Net interest and dividend income for the full year was \$96 million (2003 \$91 million), and \$26 million in the fourth quarter (2003 \$20 million). As previously reported, net interest includes a gain arising from the close out of an interest rate swap of \$30 million.

Excluding exceptional items, the effective tax rate for the full year 2004 was 27.1% compared with 27.2% for 2003. An agreement has been reached with US tax authorities that a portion of the *Zoladex* settlement, recorded as an exceptional item in 2002, is deductible for tax purposes. Consequently, an exceptional tax credit of \$58 million was recorded in the year. This credit, together with tax relief of \$9 million on costs associated with the tax free gain on the sale of Advanta BV, resulted in a post exceptional tax rate of 24.7% for the year.

In 2004, a settlement was reached in respect of currency losses arising on intra-group balances in 2000 and a credit of \$357 million has been recorded in the statement of total recognised gains and losses. No benefit had previously been recognised owing to the uncertainty of the losses being allowed for tax purposes.

Earnings per share before exceptional items grew by 18% from \$1.78 in 2003 to \$2.11 in 2004.

### Financial position, including cash flow and liquidity

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

The net book value of our assets increased from \$13,257 million at 31 December 2003 to \$14,519 million at 31 December 2004. The increase was driven primarily by retained profit after dividends of \$2,258 million and exchange benefits of \$1,092 million, less share re-purchases of \$2,212 million.

### Tangible fixed assets

Capital expenditure totalled \$1,063 million, compared with \$1,282 million in 2003. Major investments continued, particularly in R&D facilities. Depreciation of \$916 million was lower than 2003 due principally to accelerated depreciation in 2003 not repeated in 2004. The net book value of tangible fixed assets rose from \$7,536 million to \$8,083 million, including exchange effects of \$485 million.

### Goodwill and intangible assets

Additions to goodwill and intangible

assets amounted to \$151 million, whilst amortisation totalled \$311 million. There was a small write-off of goodwill in connection with *Exanta* of \$10 million. Additions included an intangible arising from the collaboration agreement with Cambridge Antibody Technology of \$34 million and capitalisation of software. Combined with the effects of exchange, however, the carrying value of goodwill and intangible assets fell slightly from \$2,884 million to \$2,826 million.

### Stocks

Stock levels at \$3,020 million were unchanged from 2003. Reductions in stock from tight operational management, high second half sales and provisions against *Exanta* and *Iressa* stocks were offset by exchange effects.

### Debtors and creditors

Debtors increased from \$5,960 million to \$6,274 million. This reflected the increased trade debtors from higher sales in the fourth quarter of 2004 (particularly in December) compared with the same period in 2003 together with exchange effects offset by decreases in tax balances.

Creditors have risen from \$7,595 million to \$7,718 million. Increases in trade creditors, exchange effects and the final dividend were compensated by decreases in tax balances.

### Cash flow

We continue to be a highly cash generative business. Although future operating cash flows may be affected by a number of factors as outlined in the business background section on page 37, we believe our cash resources will be sufficient for our present requirements and include sufficient cash for our existing capital programme, share re-purchases and any costs of launching new products, as well as the potential buy-out of Merck's interests in 2008.

Cash generated from operating activities before exceptional cash outflows was \$6,069 million compared with \$4,617 million in 2003. The increase in cash is due to higher profits and minimal working capital outflows (\$9 million in 2004 compared to \$1,101 million in 2003). In 2003, all three components of working capital led to substantial cash outflows whereas, in 2004, there were inflows on stocks (\$129 million) and creditors (\$71 million) offset by an

outflow on debtors (\$209 million). Cash flow from working capital in the fourth quarter was notably strong due mainly to stocks which, when compared with September 2004, fell for the reasons above and debtors, which also fell because sales in December were lower than in September. Cash expenditure on exceptional items was \$8 million compared with \$391 million in 2003 (which included the payment of \$355 million in settlement of the *Zoladex* investigation). Tax paid for the year was \$1,246 million, compared to \$886 million in 2003. This increase in 2004 compared to 2003 was due to the greater utilisation of foreign exchange losses in 2003, reduced trading losses brought forward to 2004 and a reduction in the level of accelerated capital allowances/tax reliefs in excess of depreciation in 2004.

### Investments, divestments and capital expenditure

In 2004, we entered into a strategic alliance with Cambridge Antibody Technology investing a total of \$138 million to acquire a 19.9% interest and an intangible asset. We disposed of Advanta BV in the second half of the year resulting in net cash proceeds of \$284 million.

Capital expenditure, including new fixed asset investments and intangible assets, totalled \$1,296 million.

### Net funds

During the year, an SEC-registered shelf debt programme was established with a total capacity of \$4 billion and in conjunction with this a \$750 million bond, repayable in 2014, was issued.

After accounting for dividends paid of \$1,378 million, net share re-purchases of \$2,110 million and exchange of \$34 million, there was a \$478 million increase in net cash funds, which totalled \$3,974 million at 31 December 2004.

### Capitalisation and shareholder return

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

### Capitalisation

At 31 December 2004, the number of shares in issue was 1,645 million. Our reserves were increased by \$1,092 million due to the effect of exchange rate movements (after tax) on translation of non-dollar denominated assets and liabilities.

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Shareholders' funds increased by a net \$1,240 million to \$14,418 million at year end. Minority interests increased from \$79 million at 31 December 2003 to \$101 million at 31 December 2004.

#### Dividend and share re-purchases

During 2004 we returned \$3,590 million in cash to shareholders through a mix of share buybacks and dividends.

Under the programme of share re-purchases, approved by the Board in January 2004, we have re-purchased and cancelled 50.1 million shares in 2004 at a cost of \$2,212 million. Together with the previous programme begun in 1999, the total number of shares re-purchased to date is 142.9 million at a cumulative cost of \$6,171 million. Under a new policy approved by the Board in January 2005, we aim to distribute the free cash generated over the next three years to shareholders.

We regard our free cash as being cash flow before returns to shareholders and financing. For 2004 free cash was \$3,932 million (net cash inflow before management of liquid resources and financing of \$2,554 million before \$1,378 million dividends paid) compared to \$1,899 million in 2003.

We paid a first interim dividend for 2004 on 20 September 2004 of \$0.295 per Ordinary Share. A second interim dividend for 2004 of \$0.645 per Ordinary Share has been declared, which the Annual General Meeting will be asked to confirm as the final dividend. This, together with the first interim dividend, makes a total of \$0.940 for the year. It is our intention that dividends will increase broadly in line with earnings growth whilst maintaining dividend cover in the two to three times range.

#### Future prospects

The setbacks with *Exanta* and *Iressa* are disappointing but the business remains robust. We expect continued sales growth, including strong prospects for *Nexium*, *Symbicort*, *Seroquel*, *Arimidex* and, with restoration of market share progress in the US, for *Crestor*. This sales growth coupled with disciplined cost management and productivity improvements should lead to good earnings growth in the next three years.

#### Financial risk management policies

##### Insurance

Our risk management processes are described in the Directors' Report on page 54. An outcome of these processes is that they enable us to identify risks which can be partly or entirely mitigated through use of insurance or which we can self-insure.

#### Ratios

As at and for the year ended 31 December	2004	2003	2002
Return on shareholders' equity (%)	27.6	24.9	27.3
Equity/assets ratio (%)	56.3	55.9	51.8
Net funds/equity ratio (%)	27.6	26.5	34.4
Number of employees	64,200	61,000	59,400

#### Sensitivity analysis 31 December 2004

Market value change favourable/(unfavourable)

Market value

Interest rate

Exchange rate

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	31 December 2004	movement		movement	
	\$m	+1% \$m	1% \$m	+10% \$m	10% \$m
Cash and short term investments	5,150			(38)	38
Long term debt, net of interest and currency swaps	(1,055)				
Foreign exchange forwards	10			(75)	75
Foreign exchange options	32			(24)	185
				<b>(137)</b>	<b>298</b>

Sensitivity analysis 31 December 2003

	Market value 31 December 2003	Market value change favourable/(unfavourable)			
		Interest rate movement		Exchange rate movement	
	\$m	+1% \$m	1% \$m	+10% \$m	10% \$m
Cash and short term investments	4,039	(2)	2	(37)	37
Long term debt, net of interest and currency swaps	(315)	24	(30)		
Foreign exchange forwards	(7)			71	(71)
Foreign exchange options	148			(114)	162
		<b>22</b>	<b>(28)</b>	<b>(80)</b>	<b>128</b>

## Financial Review continued

We negotiate best available premium rates with insurance providers on the basis of our extensive risk management procedures. In the current insurance market, level of cover is decreasing whilst premium rates are increasing. Rather than simply paying higher premiums for lower cover, we focus our insurance resources on the most critical areas, or where there is a legal requirement, and where we can get best value for money. Risks which we give particular attention to include product liability, business interruption, directors and officers liability, and property damage.

### Taxation

We operate in most countries in the world and are subject to many tax jurisdictions and rules. As a consequence we are subject to tax audits, which by their nature are often complex and can require several years to conclude. We draw a distinction between tax planning using artificial structures and optimising tax treatment of business transactions and only engage in the latter.

### Treasury

Our financial policies covering the management of cash, borrowings and foreign exchange are deliberately conservative and intended to support our objective of maintaining shareholder value by managing and controlling our financial risks. Our treasury operations are conducted in accordance with policies and procedures approved by the Board. The treasury activities are managed centrally from London. Over 90% of our cash and short term investments are managed directly from London where possible and practicable. With only limited and specifically approved

and Swedish krona. As a result, our operating profit in US dollars can be affected by movements in exchange rates.

The significant weakening of the US dollar against sterling, the Swedish krona and the euro has continued in 2004. This has had the effect of increasing the dollar value of our European sales compared with the previous year whilst our UK and Swedish costs have also increased correspondingly. Our approach to managing currency exposures to mitigate these and other currency effects is described below.

Currency exposure is managed centrally using rolling 12 month currency cash flow forecasts for our major currencies of Swedish kronor, sterling and euros and monthly updated foreign currency working capital forecasts reported by subsidiaries. We use derivative financial instruments, principally currency options and forward foreign exchange contracts, to manage potential extreme movements in the exchange rates that underlie our currency exposure. It is our policy neither to engage in any speculative transactions nor to hedge currency translation exposures arising from the consolidation of our non-US dollar subsidiaries. Key controls, applied to transactions in derivative financial instruments, are to use only instruments where good market liquidity exists, to revalue all financial instruments daily using current market rates and to sell options only to offset previously purchased options. The transaction exposures that arise from non-local currency intercompany sales and transactions with third parties of our subsidiaries are, where practicable,

### Funding risk

The management of our liquid assets and debt balances are co-ordinated and controlled centrally by our treasury operations. We have significant positive cash flows and the liquidity of major subsidiaries is co-ordinated in cash pools and concentrated daily in London. The cash balances and unutilised debt programme are available to finance the ongoing working capital and capital investment requirements of our operations.

### Interest rate risk

Our policy is to match the interest rate exposure on our gross debt balance with that arising on our surplus cash position. The net effect of this is to use interest rate swaps to receive fixed rate interest on our two outstanding bonds (\$1,030 million) in exchange for paying floating rate interest referenced to six month US\$ LIBOR. The majority of our cash balance is held with third party fund managers who return a target yield referenced to seven day US\$ LIBID. In addition to interest rate swaps, we also use forward rate agreements to manage any short term timing difference between the swapped debt interest expense and cash interest income. During 2004, interest rate swaps which partially hedged the 2023 bond (\$300 million) were terminated and replaced with new swaps, which hedged this bond more effectively.

### Credit exposure

Our exposure to financial counterparty credit risk is controlled by our treasury team centrally by establishing and monitoring counterparty limits. Our centrally managed funds are invested almost entirely with counterparties whose credit rating is A or better. External fund managers which

exceptions, all currency and interest rate hedging is conducted from London. Operating units benefit from local currency billing which has the effect of consolidating their foreign exchange exposures to central treasury.

#### **Foreign exchange**

The US dollar is our most significant currency. As a consequence, we have chosen to account for our results in US dollars and manage our exposures against US dollars accordingly. Approximately 55% of our sales in 2004 were denominated in currencies other than the US dollar, while a significant proportion of our manufacturing and R&D costs are denominated in sterling

fully hedged using forward foreign exchange contracts and purchased currency options. Longer term forecast cash flow currency exposure is managed by forecasting cash flows by major currency for 12 months forward on a monthly rolling basis. In 2004 we modified our policy whereby we now seek to limit the potential downside by hedging 95% of these cash flows, using a mixture of purchased currency options (generally out of the money) and forward exchange contracts. This new policy only hedges currency movements outside specified limits; within these limits we are effectively unhedged.

accounted for \$2.5 billion of our cash are rated AAA by Standard & Poor. Trade debtor exposures are managed locally in the operating units where they arise. We are exposed to customers ranging from large private wholesalers to government backed agencies and the underlying local economic and sovereign risks vary throughout the world. Where appropriate, we endeavour to minimise risks by the use of trade finance instruments such as letters of credit and insurance.

#### **Sensitivity analysis**

The sensitivity analysis, set out in this review on page 41, summarises the sensitivity of

the market value of our financial instruments to hypothetical changes in market rates and prices. Changes to the value of the financial instruments are normally offset by our underlying assets and liabilities. The range of variables chosen for the sensitivity analysis reflects our view of changes which are reasonably possible over a one year period. Market values are the present value of future cash flows based on market rates and prices at the valuation date. Market values for interest rate risk are calculated using third party systems that model the present value of the instruments based on the market conditions at the valuation date. For long term debt, a favourable change in market value for interest rate risk results in a decline in the absolute value of debt.

The sensitivity analysis on page 41 assumes an instantaneous 100 basis point change in interest rates in all currencies from their levels at 31 December 2004, with all other variables held constant. Because all our debt was hedged effectively to floating rate in 2004, changes in interest rates will not change the carrying value of debt after interest rate and currency swaps. Based on the composition of our long term debt portfolio as at 31 December 2004 (which is predominantly floating rate), a 1% increase in interest rates would result in an additional \$10 million in interest being incurred per year. The exchange rate sensitivity analysis on page 41 assumes an instantaneous 10% change in foreign currency exchange rates from their levels at 31 December 2004, with all other variables held constant. The +10% case assumes a 10% strengthening of the US dollar against all other currencies and the -10% case assumes a 10% weakening of the US dollar.

### Critical accounting policies and estimates

Our Financial Statements are prepared in accordance with accounting principles generally accepted in the UK ( UK GAAP ) and the accounting policies employed are set out under the heading Financial Statements Accounting Policies on pages 76 and 77. In applying these policies, we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. The actual outcome could differ from those estimates. Some of these policies require a high level of judgement, either because the areas are

especially subjective or due to their complexity. We believe that the most critical accounting policies and significant areas of judgement and estimation are in revenue recognition, research and development, goodwill and intangible assets, provisions for contingent liabilities, post-retirement benefits, taxation and share-based compensation. We believe these will continue to be the critical accounting policies when we transition to international accounting (as discussed below), although the provisions of certain policies will change.

### Revenue recognition

Revenue represents sales of products (net of estimated rebates) to external third parties and excludes intercompany income and value added taxes. We also receive income from royalties and from sales of intellectual property, brands and product lines which are included in other operating income.

- > Sales of products to third parties: Sales revenue is recorded as turnover in our Financial Statements and valued at the invoiced amount (excluding sales and value added taxes) less estimated provisions for product returns and rebates given to managed care and other customers a particular feature in the US. Cash discounts for prompt payment are also deducted from sales. Revenue is recognised when title passes to the customer which is usually either on shipment or on receipt of goods by the wholesaler depending on local trading terms. Industry practice in the US allows wholesalers and pharmacies to return unused stocks within six months of shelf-life expiry. At point of sale, we estimate the quantity and value of goods which may ultimately be returned. Our returns provisions are based on actual experience over the preceding 12 months, although in certain situations, for example a new product launch or at patent expiry, further judgement may be required. When products face generic competition, we give particular attention to the possible level of returns. Overall, we believe that our estimates are reasonable.

Similarly, at the time of invoicing sales, rebates which could be paid out over the following six to nine months are estimated. These rebates typically arise

from sales contracts with managed care organisations and hospitals and from Medicaid best price contracts. The estimates are made on a customer by customer basis taking into account specific contract provisions and are reviewed each month. We believe that we have been reasonable in our estimates for future rebates using a similar methodology to that of previous years. Inevitably, however, such estimates involve judgements on future sales levels and the extent to which

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customers will access different incentive levels. Experience has shown that these estimates have been substantially accurate in the past.

A further feature that significantly influenced our sales in the US market was wholesaler buying patterns. Wholesalers would place orders which were significantly larger than their normal levels of demand ahead of anticipated price increases or would seek to build up or run down their stock levels for other reasons. If such speculative orders were shipped shortly before a quarter or year end, revenue could be recorded in the current financial period in respect of the following period's underlying demand, distorting the financial results from one period to the next. During 2003, we began negotiations with wholesalers to enter into inventory management agreements with the aim of minimising stock movements caused by speculative purchasing. These negotiations continued in 2004 and we now have agreements with 15 wholesalers, providing more predictability to shipments in the US. We continue to track wholesaler stock levels by product, using our own and wholesaler data and, where we believe such distortions occur, we disclose in the Annual Report for each product where shipments may be out of line with underlying prescription trends. We do not offer any incentives to encourage wholesaler speculative buying and attempt, where possible, to restrict shipments to underlying demand when such speculation occurs.

- > Royalty income:  
Royalty income is recorded under other operating income in the Financial
-



## Financial Review continued

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

- > Sales of intangible assets (such as intellectual property, brands, product lines and goodwill): A consequence of charging all internal R&D expenditure to the profit and loss account in the year that it is incurred (which is normal practice in the pharmaceutical industry) is that we own valuable intangible assets which are not recorded on the balance sheet. We also own acquired intangible assets, which may be included on the balance sheet (see [Research and development](#) below). As a consequence of regular reviews of product strategy, from time to time we sell such assets and generate income. In a simple situation, the recognition of income may be easily defined but often the transfer of title can require ongoing commitment by us (for example, ongoing manufacturing arrangements, technology transfer and transfer of product licences). In these circumstances, the recognition of revenue may be deferred over the period of our ongoing commitment. Profits or losses from the sale of product related intangible assets are classified in other operating income and are stated after taking account of product disposal costs, the valuation of which includes a degree of judgement.

### Research and development

Our business is underpinned by our marketed products and development portfolio. The R&D expenditure to generate these products is charged to the profit and loss account in the year that it is incurred. This policy is in line with practice adopted by all major pharmaceutical companies.

Purchase of, for example, intellectual property and product rights to supplement our R&D portfolio can lead to differing accounting treatment depending on our assessment of the nature of the acquisition and the degree of risk involved. For

example, payments in respect of rights to a compound in early stage development would normally be expensed immediately against income on the basis that, at this point, the probability of the compound successfully reaching the market place is still low. Payments in respect of rights to a compound in late stages of development, however, or to one already being marketed, would probably be capitalised as an intangible asset (see [Goodwill and intangible assets](#) below) as the prospect of success is much greater. On transition to international accounting, more of these payments are likely to be capitalised.

### Goodwill and intangible assets

We have significant investments in goodwill and intangible assets as a result of acquisitions of businesses and purchases of such assets as product development and marketing rights. Under UK GAAP, these are amortised over their estimated useful lives. Changes in these lives would result in different effects on the profit and loss account. We estimate that a one year reduction in the estimated useful lives of goodwill and intangible assets would increase the annual amortisation charge by \$25 million. A substantial part of our investments in intangible assets and goodwill relates to the restructuring of the Astra-Merck joint venture in 1998 and we are satisfied that the carrying values are fully justified by estimated future earnings. Goodwill and intangible assets are reviewed for impairment where there are indications that their carrying values may not be recoverable and any impairments are charged to the profit and loss account. Tests for impairment are based on discounted cash flow projections, which require us to estimate both probability adjusted future cash flows and an appropriate risk-free discount rate. Such estimates are inherently subjective. Other than the \$10 million write-off in connection with *Exanta*, no impairments to goodwill or intangible assets were identified in 2004 (2003 \$nil, 2002 \$nil). Under UK GAAP, the merger of Astra and Zeneca in 1999 was recorded as a *merger of equals* (pooling of interests). Under US GAAP, the merger has been accounted for as the acquisition of Astra by Zeneca as discussed in more detail on page 125. On transition to international accounting, goodwill amortisation will cease.

### Contingent liabilities

In the normal course of business, contingent liabilities may arise from environmental liabilities connected with our current or former sites, from product specific and general legal proceedings, or from guarantees. Where we believe that potential liabilities have a low probability of crystallising or are very difficult to quantify reliably, we treat these as contingent liabilities. These are not provided for but are disclosed in the notes. Further details of these are set out in Note 30 to the Financial Statements. Although there can be no assurance regarding the outcome of legal proceedings, we do not expect them to have a materially adverse effect on our financial position or profitability. We also have significant commitments which are not currently recognised in the balance sheet arising from our relationship with Merck. These are described more fully in [Off-balance sheet transactions, contingent liabilities and](#)

commitments below.

**Post-retirement benefits**

We account for the pension costs relating to the UK retirement plans under SSAP 24 and under local accounting practices for non-UK subsidiaries due to the cost and difficulty of obtaining SSAP 24 information for non-UK schemes. In all cases, the pension costs are assessed in accordance with the advice of independent qualified actuaries but require the exercise of significant judgement in relation to assumptions for future salary and pension increases, long term price inflation and investment returns. SSAP 24 permits flexibility in the actuarial assumptions and bases to be used and the application of different assumptions could have a significant effect on the amounts reflected in the Financial Statements. We consider that the assumptions and bases detailed in Note 28 to the Financial Statements are appropriate for the business.

The off-balance sheet aspects of post-retirement benefits are discussed on page 47.

On pages 100 to 103, we also provide additional disclosures in accordance with FRS 17. Had FRS 17 been applied in 2004, the charge to profit and loss account for the defined benefit schemes would have been approximately \$251 million.

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FRS 17 became fully operational from 1 January 2005. However, from that date the consolidated financial statements will be prepared under international accounting principles, as discussed on page 48. We intend to adopt the recently revised provisions of the international post-retirement benefits standard which are substantially the same as FRS 17.

### Taxation

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

Deferred tax asset valuation allowances are made where it is more likely than not that the asset will not be realised in the future. These valuations require judgements to be made including the forecast of future taxable income.

### Share-based compensation

Through the Remuneration Committee we offer share options to certain employees as part of their compensation and benefits packages, designed to improve alignment of the interests of employees with shareholders. Details of these are given in Note 29 to the Financial Statements. On transition to international accounting in 2005, we will be required to value share

options granted and charge them against income. At present, US GAAP requires some share option costs to be charged to the profit and loss account and stipulates disclosure of the cost should all eligible options be expensed (as set out on page 130). Had a requirement to expense share options been in place in 2004, we estimate an additional charge of approximately \$147 million would have arisen. This charge has been calculated using the Black-Scholes model as a valuation basis. This would result in a charge to the profit and loss account but would have no impact either on our net assets or on our current or future cash flows.

### Off-balance sheet transactions, contingent liabilities and commitments

Details of our contingent liabilities and commitments are set out in Note 30 to the Financial Statements. We have no off-balance sheet entities and our hedging activities are non-speculative. The table below sets out our minimum contractual obligations at the year end.

### Arrangements with Merck Introduction

In 1982, Astra AB set up a joint venture with Merck & Co., Inc. for the purposes of selling, marketing and distributing certain Astra products in the US. In 1998, this joint venture was restructured (the Restructuring). Under the Restructuring, a US limited partnership, in which Merck is the limited partner and we are the general partner, was set up and we obtained control of the joint venture's business subject to certain limited partner and other rights held by Merck and its affiliates. These rights provide Merck with safeguards over the activities of the partnership and place some limitations over our discretion to operate with complete commercial freedom. The Restructuring agreements provide

for the following ongoing payment and termination arrangements:

- > Annual contingent payments
- > Partial Redemption
- > First Option
- > Second Option

In addition, included in the assets and liabilities covered by the Restructuring is a loan note receivable by us from Merck with a face value of \$1.4 billion. Each of these elements is discussed in further detail below.

Under the terms of the Restructuring, the merger in 1999 between Astra and Zeneca triggered two one-time payments from us to Merck:

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a Lump Sum Payment of \$809 million, which was charged to the profit and loss account, as a result of which Merck relinquished any claims to Zeneca products; and

- > an Advance Payment of \$967 million. This Advance Payment was calculated as the then net present value of \$2.8 billion discounted from 2008 to the date of payment at a rate of 13% per annum and caused Merck to relinquish any rights, including contingent payments on future sales, to Astra products with no existing or pending US patents at the time of the merger. As the Advance Payment provides us with relief from future payments on these products (and relieves us also of any other potential obligations or restrictions in respect of these products), this amount has been capitalised as an intangible asset and is being amortised over 20 years. The Advance Payment is subject to a true-up in 2008, as discussed under First Option below.

### Contractual obligations

	Payments due by period				Total \$m
	Less than 1 year \$m	1-3 years \$m	3-5 years \$m	Over 5 years \$m	
Bank loans and other borrowings	142			1,030	1,172
Operating leases	112	108	63	69	352
Merck arrangements	205	450	4,677		5,332
Other	298				298
<b>Total</b>	<b>757</b>	<b>558</b>	<b>4,740</b>	<b>1,099</b>	<b>7,154</b>

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### Annual contingent payments

We make ongoing payments to Merck based on sales of certain of our products in the US (the contingent payments on the agreement products). As a result of the 1999 merger, these contingent payments (excluding those in respect of *Prilosec* and *Nexium*) cannot be less than annual minimum sums between 2002 and 2007 ranging from \$125 million to \$225 million. Our payments have exceeded the minimum level in 2002 to 2004 and we have no reason to believe that the annual payments in the future will fall below the minimum obligations.

### Partial Redemption

In 2008, there will be a partial redemption of Merck's limited partnership interest which will end Merck's interests (including rights to contingent payments) in respect of certain of the agreement products by distribution to Merck of an amount calculated as a multiple of the average annual contingent payments from 2005 to 2007 on the relevant products, plus \$750 million.

Marketed products covered by the Partial Redemption include *Toprol-XL*, *Pulmicort* and *Rhinocort*. The Partial Redemption will also end Merck's interest in *Symbicort*, which is not yet launched in the US.

### First Option

In 2008, a calculation will be made of the Appraised Value, being the net present value of the future contingent payments in respect of all agreement products not covered by the Partial Redemption, other than *Prilosec* and *Nexium*. Payment of this amount to Merck in 2008 is, however, contingent on Merck's exercise of the First Option. Exercise of the First Option will require us to buy out Merck's interest in these products at the Appraised Value. Should Merck not exercise this option in 2008, we may exercise it in 2010 for a sum equal to the 2008 Appraised Value. If neither Merck nor we exercise the option, the contingent payment arrangements in respect of these agreement products will continue (as will our other potential obligations and restrictions in respect of these products) and the Appraised Value will not be paid.

Products covered by the First Option include *Atacand*, *Plendil*, *Exanta* and *Lexxel*, plus certain compounds still in development.

In addition, in 2008 there will be a true-up of the Advance Payment. The calculation of this will be based on a multiple of the average annual contingent payments from 2005 to 2007 in respect of all the agreement products with the exception of *Prilosec* and *Nexium* (subject to a minimum of \$6.6 billion), plus other defined amounts (totalling \$912 million). It is then reduced by the Appraised Value (whether paid or not), the Partial Redemption and the Advance Payment (at its undiscounted amount of \$2.8 billion) to determine the true-up amount. The true-up will be settled in 2008 irrespective of whether the First Option is exercised and this could result in a further payment by us to Merck or a payment by Merck to us.

Should Merck exercise the First Option in 2008, we will make payments in respect of the Partial Redemption, the First Option and the true-up totalling a minimum of \$4.7 billion. If we exercise the First Option in 2010, the combined effect will involve a minimum aggregate amount payable to Merck in 2008 and 2010 of the same amount.

### Loan note receivable

In 2008, at the same time as the settlement of the Partial Redemption and the true-up, Merck will settle the loan note receivable by paying us \$1.4 billion.

### Second Option

A Second Option exists whereby we have the option to re-purchase Merck's interests in *Prilosec* and *Nexium* in the US. This option is exercisable by us two years after the exercise of the First Option, whether the First Option is exercised in either 2008 or 2010. Exercise of the Second Option by us at a later date is also provided for in 2017 or if combined annual sales of the two products fall below a minimum amount provided, in each case, that the First Option has been exercised. The exercise price for the Second Option is the fair value of these product rights as determined at the time of exercise.

If the Second Option is exercised, Merck will relinquish all its interests (including rights to contingent payments) in our products.

**Accounting treatment**

The precise amount of settlements with Merck under the Partial Redemption, the First Option and the true-up of the Advance Payment cannot be determined at this time. The Partial Redemption and true-up are calculated based, in part, on trading performance between 2005 and 2007, and payment of the First Option is contingent upon Merck (or us) exercising the First Option. If Merck exercises the First Option in 2008, the net minimum payment to be made to Merck, being the combined payments of \$4.7 billion less the repayment of the loan note of \$1.4 billion, would be \$3.3 billion.

In accounting for the Restructuring in 1998, the loan note was included in the determination of the fair values of the assets and liabilities to be acquired. The loan note was ascribed a fair value of zero on acquisition and on the balance sheet because we estimate that the net minimum payment of \$3.3 billion equated to the fair value of the trading rights to be acquired under the Partial Redemption and First Option.

We consider that the payments described under the headings above, including the Second Option, represent the acquisition of future trading rights which will terminate Merck's interests in the agreement products (including their rights to contingent payments) and which will provide us with unencumbered discretion in our operations in the US market. Merck's interests will only be terminated as and when the payments are made and, accordingly, the acquisition of these trading rights will only be reflected in the Financial Statements at that point. The trading rights will be accounted for under the extant guidance when the payments are made, with allocations to intangibles and goodwill, as appropriate.

As noted, the calculation of the purchase price of the trading rights is based partially on the contingent payments made in 2005 to 2007 (subject to the minimum amount) and is likely to be substantially driven by the sales of *Toprol-XL*, *Pulmicort*, *Rhinocort* and *Atacand*. However, we anticipate that the benefits that accrue to us from these payments will begin to be realised from

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2008 onwards based on contributions from those products that have already been launched (for example, *Rhinocort* and *Atacand*), those that are due to be launched in the US (in particular, *Symbicort*) and those that are in development.

Our ongoing monitoring of the projected payments to Merck and the value to us of the related trading rights takes full account of changing business circumstances and the range of possible outcomes to ensure that the payments to be made to Merck are covered by the benefits expected to be realised by us. Should our monitoring reveal that these payments exceed the benefits expected to be realised, we will recognise a provision for an onerous contract.

The annual contingent payments on agreement products are expensed as incurred.

### Post-retirement benefits

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

Under FRS 17, the disclosures on page 101 highlight a deficit of \$1,183 million, after deferred tax, for the major Group post-retirement defined benefit schemes. FRS 17 prescribes detailed rules for the calculation of scheme assets and liabilities and indicates the net accounting surplus or deficit that exists at the balance sheet date. Fluctuations in investment conditions and/or FRS 17 prescribed assumptions can result in significant volatility in the surplus or deficit. Pension and other post-retirement schemes, however, are managed over the long term.

Investment and liability decisions are based on underlying actuarial and economic circumstances with the intention of ensuring that the schemes have sufficient assets to meet liabilities as they fall due, rather than meeting accounting requirements. This actuarial approach tends to produce less volatility than is likely under FRS 17. As noted above, we will adopt provisions under the equivalent international standard on post-retirement benefits which are similar to FRS 17.

The overall deficit in the major defined benefit schemes increased from \$1,521 million at 31 December 2003 to \$1,703 million at 31 December 2004. This increase is due primarily to the effects of changes in underlying assumptions with regard to scheme liabilities. For example, in the largest scheme, in the UK, plan assets have increased in sterling from £2,385 million to £2,564 million, reflecting strong performance. Liabilities have increased from £2,875 million to £3,112 million with changes in assumptions contributing significantly to this rise. As a result, the deficit has risen by £58 million from £490 million to £548 million. Exchange effects have exacerbated these underlying effects in our reported US dollar amounts such that the corresponding increase in the UK fund deficit is approximately \$185 million. At the last actuarial valuation at 31 March 2004, the market value of the UK fund's assets was £2,453 million, representing a solvency ratio of 96.1% on the fund's liabilities. The trustee manages both investments and liabilities closely and follows a strategy of awarding mandates to specialist, active investment managers.

### Taxation

We have various contingent tax liabilities. Details of material contingent tax liabilities are:

- > We have made certain double taxation relief claims in accordance with our understanding of existing law. We understand that other taxpayers have recently been denied credit for foreign taxes in similar claims. The estimated tax credit for foreign taxes in similar claims. The estimated tax exposure provided for in respect of this issue is \$197 million although the potential additional losses above and beyond the amount provided are estimated to be up to \$130 million; however, we believe that it is unlikely that these additional losses will arise. We expect a definitive ruling or clarification of law on the availability of credit for foreign taxes in the next 12 months. Until these cases are resolved either in Court or through clarification of existing law, there is some risk that credits may not be allowed giving rise to effective double taxation. In this event, we will seek relief under the relevant double tax treaty.

- > We face a number of transfer pricing audits in jurisdictions around the world. The issues under audit are often complex and can require many years to resolve. Accruals for tax contingencies require us to make estimates and judgements with respect to the ultimate outcome of a tax audit and actual results could vary from these estimates. The total accrual included in the financial statements to cover the worldwide exposure to transfer pricing audits is \$400 million. It is not possible to estimate any additional exposure that may arise or the timing of tax cash flows in relation to each outcome.

## New accounting standards

New UK or US applicable accounting standards which have been issued (both adopted and not yet adopted) are discussed on pages 70 and 126 respectively.

The Accounting Standards Board has issued a number of Financial Reporting Standards in 2004, many designed to align UK GAAP with international accounting. Because of our transition to international accounting, discussed below, we will not be required to adopt these standards.

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## Financial Review continued

### International accounting

Under European legislation, we are required to adopt International Financial Reporting Standards (IFRSs) and International Accounting Standards (IASs) in the preparation of our Financial Statements from 2005 onwards. Extensive work has been undertaken by the international standard setter, the International Accounting Standards Board (IASB), over the past three years to improve existing standards and develop new ones. Application of a particular standard issued by the IASB by us is dependent on the European Union (EU) endorsing that standard. The work of the IASB and the EU in development and endorsement is now largely complete and, except as disclosed below, the standards that we will apply from 1 January 2005 are now in place.

Our project to manage the transition of financial reporting from UK GAAP to international accounting has completed the majority of its work. This work has included assessing the impacts of individual standards on financial information, providing comprehensive training to all our finance staff and appropriate non-finance personnel and restating our financial data. In the case of the latter work, on 25 October 2004 we published information with regard to 2003 and the first half of 2004, whilst on 27 January 2005, we issued data on the remainder of 2004. The changes in income and net assets from UK GAAP to international accounting can be summarised as follows:

	2004	2003
<b>Income</b>	\$m	\$m
UK GAAP	3,831	3,059
Share-based payments	(167)	(136)
Employee benefits		(15)
Business combinations	49	59
Financial instruments	(128)	(16)
Income tax	66	82
Others	19	3
IFRS/IAS	3,670	3,036
<b>Net assets</b>	2004	2003
	\$m	\$m
UK GAAP	14,519	13,257
Share-based payments	(1)	19
Employee benefits	(1,435)	(1,242)
Business combinations	106	57

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Financial instruments	28	134
Income tax	128	(8)
Dividend	1,061	914
Others	112	78
IFRS/IAS	14,518	13,209

The major areas of ongoing impact on our net profit and shareholders' funds are likely to continue to be share-based payments, goodwill amortisation and deferred tax. The reconciliation from UK GAAP income in 2004 was also impacted by one-off gains on financial instruments that have been recognised in earlier years under IFRS/IAS.

Further details can be found on pages 139 to 146 and on our website, [astrazeneca.com](http://astrazeneca.com). The information was prepared on the basis of our best understanding of the standards endorsed by the EU that we will be subject to. At present, the amendment to the international standard on post-retirement benefits, IAS 19, to allow full recognition of actuarial gains and losses in reserves has not been endorsed by the EU. Neither has the standard on share-based payments, IFRS 2. Similarly, changes in 2005 to the international standard on recognition and measurement of financial instruments, IAS 39, may allow us to use the fair value option for certain of our liabilities, if issued and endorsed. The effects of having to change our assumptions as a result of developments in these areas are not significant.

### Sarbanes-Oxley Act section 404

As a consequence of our listing on the New York Stock Exchange, AstraZeneca is required to comply with those provisions of the US Sarbanes-Oxley Act applicable to foreign issuers. Section 404 of this legislation requires companies annually to assess and make public statements about the quality and effectiveness of their internal control over financial reporting. As a non-US company, AstraZeneca is first required to report formally on its compliance with section 404 in respect of its financial year ending 31 December 2005. However we have already started preparations and initiated an internal project to review our readiness for compliance and to make improvements to our internal control over financial reporting where necessary.

The project is being centrally directed and is being reviewed regularly by the Senior Executive Team and by the Audit Committee. Our external auditor, KPMG Audit Plc, is involved, helping us to understand the standards we will be required to meet by the end of 2005. Our Audit Committee continues to monitor KPMG's involvement to ensure the independence of our external auditor is not impaired.

Our approach to the project has been to select key transaction and financial reporting processes in our largest operating units and a number of specialist areas such as financial consolidation and reporting, treasury operations and taxation so that, in aggregate, we have covered a significant proportion of each of the key line items in our Financial Statements. Each of these operating units has ensured that its relevant in-scope processes and controls are formally documented to the standards required by the SEC, taking into account the guidance provided by the US Public Company Accounting Oversight Board's Auditing Standard No.2. This phase of the project has largely been completed although the ongoing requirements of section 404 mean that we will need to institutionalise procedures to ensure that, henceforth, our documentation remains up-to-date at all times.

We have started the initial testing of these controls to satisfy ourselves as to their

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Sales by therapy area (2003 and  
2002)

	2003			2002	2003 compared to 2002	
	\$m	Growth underlying \$m	Growth due to exchange effects \$m	\$m	Growth underlying %	Growth reported %
Cardiovascular	3,910	92	249	3,569	3	10
Gastrointestinal	5,943	(1,026)	305	6,664	(16)	(11)
Infection	476	10	26	440	2	8
Neuroscience	2,833	289	126	2,418	12	17
Oncology	2,743	177	197	2,369	8	16
Respiratory and Inflammation	2,261	275	168	1,818	15	24
Other pharma	152	75	12	65	115	134
Others	531	(2)	35	498		7
<b>Total</b>	<b>18,849</b>	<b>(110)</b>	<b>1,118</b>	<b>17,841</b>		<b>6</b>

Sales by growth, patent expiry and base  
products (2003 and 2002)

	2003			2002	2003 compared to 2002	
	\$m	Growth underlying \$m	Growth due to exchange effects \$m	\$m	Growth underlying %	Growth reported %
Growth*	8,244	2,435	413	5,396	45	53
Patent expiry**	3,221	(3,019)	260	5,980	(50)	(46)
Base	7,384	474	445	6,465	7	14
<b>Total</b>	<b>18,849</b>	<b>(110)</b>	<b>1,118</b>	<b>17,841</b>		<b>6</b>

\* *Atacand, Arimidex, Casodex, Crestor, Faslodex, Iressa, Nexium, Seroquel, Symbicort and Zomig*

\*\*  *Losec, Zestril and Nolvadex*

operational effectiveness. Where the documentation phase has indicated that controls are missing or not fully effective, we have planned remediation work as necessary. Similarly, if the results of our testing indicate that the controls are not fully operational or that evidence of their operation is lacking, we are building necessary remediation into the plans. We plan to have remediation of key controls substantially complete by mid-2005 to allow time for the controls to be operational and to be formally tested by both management and our auditors in the second half of 2005.

Our work has shown that, whilst most controls function appropriately, some areas require additional work and improvement. We do not believe that any of these identified areas constitute a material weakness nor do we anticipate that they will affect our 2005 year end assessment of the effectiveness of our internal controls over financial reporting.

Clearly there are significant costs, both financial and time, involved in this project and the future compliance with section 404. Nevertheless, we regard it as an opportunity

for AstraZeneca to review thoroughly its internal control environment and to ensure that our operating units throughout the Group are using cost-effective best practice.

The following information is provided in accordance with US requirements.

## Results of operations summary analysis of year to 31 December 2003

The tables on pages 49 and 50 show our sales by therapy area and by growth/patent expiry/base products and operating profit for 2003 compared to 2002.

### Reported performance

Our sales increased by 6% compared to 2002, rising from \$17,841 million to \$18,849 million. Operating profit before exceptional items fell from \$4,356 million to \$4,111 million, a decrease of 6%.

2003 saw our portfolio transformation substantially completed. We absorbed the full year effects of generic competition for *Losec/Prilosec, Zestril and Nolvadex* and launched *Crestor*.

### Underlying performance

#### Sales

After the effects of changing product mix, and excluding the effects of exchange, our underlying sales remained virtually unchanged. Our sales performance was affected by the loss of \$3,019 million underlying sales in *Losec/Prilosec, Zestril and Nolvadex* which was compensated by strong performances elsewhere in the portfolio. In particular, underlying sales for key growth and launch products increased by \$2,435 million (up 45%) to \$8,244 million.

Gastrointestinal was still our largest therapy area, accounting for over 31% of total sales; continued strong growth from *Nexium* restricted the declines seen in the *Losec/Prilosec* area. In Cardiovascular, *Crestor* and *Seloken/Toprol-XL* sales more than offset the 50% decline in *Zestril* sales resulting in an overall underlying performance up 3%. Oncology sales increased by 8% with *Arimidex, Iressa* and *Casodex* all mitigating the fall in *Nolvadex* sales. Neuroscience growth was 12% driven by a 27% increase in *Seroquel* sales

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Financial Review

## Financial Review continued

Operating profit (2003 and 2002)	2003			2002	2003 compared to 2002	
	\$m	Growth underlying \$m	Growth due to exchange effects \$m	\$m	Growth underlying %	Growth reported %
Sales	18,849	(110)	1,118	17,841		6
Cost of sales	(4,469)	211	(160)	(4,520)	5	(1)
Other operating costs	(10,469)	(537)	(724)	(9,208)	(6)	(14)
Other operating income	200	(55)	12	243	(23)	(18)
<b>Operating profit</b>	<b>4,111</b>	<b>(491)</b>	<b>246</b>	<b>4,356</b>	<b>(11)</b>	<b>(6)</b>

whilst Respiratory and Inflammation performance improved by 15% with the most significant performance from *Symbicort*.

Although wholesaler stocking patterns had an impact on the quarterly phasing of sales in 2003, for the year as a whole we estimate that changes in excess wholesaler stocks had little or no effect on sales growth.

We discuss the performances of the therapy areas and the individual products in those areas in more detail in the appropriate sections of the Operational Review.

#### Geographic analysis

In the US, sales declined by 6% for the full year but, excluding the three products which faced generic erosion *Losec/Prilosec*, *Zestril* and *Nolvadex* increased 36%. Growth products with strong performances included *Nexium*, *Seloken/Toprol-XL* and *Seroquel*; *Iressa* and *Crestor* were launched in the US in 2003. Sales in Europe increased 2% for the full year, as strong sales growth for *Nexium*, *Symbicort*, *Seroquel* and the oncology products more than offset declines in *Losec/Prilosec*, *Zestril* and *Pulmicort*. Sales volumes increased by 5% but overall prices were lower by 3%.

Sales in Japan were up 14% for the full year, as a result of increases in *Losec/Prilosec*, *Seroquel* and a strong oncology portfolio.

We discuss the geographic performances in more detail in the appropriate sections of the Geographic Review.

#### Operating margin and retained profit

Underlying operating profit declined by 11%. Operating margin fell from 24.4% to 21.8%. Currency had a neutral effect on operating margin. Although positive on

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gross margin, the effect was negative on SG&A and R&D costs. Gross margin increased 1.6 percentage points from 74.7% to 76.3% as a result of three factors – reduced payments to Merck following the lower proportion of sales of Merck-linked products improved margin by 1.7 percentage points; underlying costs of sales declined by 0.7 percentage points, and the remainder was due to exchange benefits. These factors were marginally offset by a provision for disposal of a surplus manufacturing facility.

In aggregate R&D and SG&A grew by 5.8%, in underlying terms, with currency movements adding 8%. Against unchanged sales, both R&D and SG&A increased as a percentage of sales and exchange added 0.6 percentage points to these lines in combination. R&D increased 1.1 percentage points to 18.3% with spending including several up-front payments on collaboration agreements. SG&A grew by 2.8 percentage points to 36.4% as a result of the launches of *Crestor* and some field force increases in Europe and Japan.

Other income was \$43 million lower principally due to the gain on disposal of Sular in the first quarter of 2002.

Net interest and dividend income was \$91 million, benefiting in comparison with 2002 as several small exchange and market revaluation losses were absent in 2003.

Excluding exceptional items, the effective tax rate for the full year 2003 was 27.2% compared with 26.8% for 2002. The increase in the effective rate reflected a change in the mix of countries where profit was earned. During the year a transfer pricing agreement was reached between the US and UK governments for the years 1987 to 2001.

### Financial position including cash flow and liquidity

The net book value of our assets increased from \$11,226 million at 31 December 2002 to \$13,257 million at 31 December 2003. The increase was driven by the net profit for the year of \$3,036 million and consolidation translation gains of \$1,427 million, offset by re-purchases of shares and the 2003 dividends, amounting to \$1,154 million and \$1,350 million, respectively.

### Cash flow

Before exceptional cash expenditure, we generated \$4,617 million cash inflow from operations in 2003, lower than the corresponding figure of \$5,686 million in 2002. Lower profits after depreciation and amortisation addbacks accounted for \$85 million but the major effects were from significant working capital outflows, particularly from debtors and creditors. Expenditure on exceptional items was higher than in 2002 due to the cash settlement of the US Department of Justice investigation into *Zoladex*. Tax cash outflows were \$886 million including the transfer pricing settlement concluded in the year whilst cash inflows from interest improved to \$76 million. We applied the remaining cash in continuing our share re-purchase programme, continued investment in fixed assets (slightly higher than 2002 at \$1,635 million after the investment in Abgenix of \$100 million) and dividends (\$1,222 million). As a result, our net cash outflow before non-equity financing was \$430 million compared to an inflow in 2002 of \$902 million.

### Investments, divestments and capital expenditure

There were no significant acquisitions or disposals in 2003 or 2002. Our cash expenditure in 2003 on fixed assets (including intangible assets, goodwill and fixed asset investments) totalled

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\$1,597 million (net of disposals of \$38 million). This expenditure was broadly similar to 2003 (expenditure of \$1,543 million net of \$66 million disposals).

## US GAAP information

### 2002 2004

Our Financial Statements have been prepared in accordance with UK GAAP which differs in certain significant respects from US GAAP. In particular, under US GAAP, the AstraZeneca merger has been accounted for as a purchase accounting acquisition of Astra AB (Astra) by Zeneca Group PLC (Zeneca). Although there are several differences between our net income and assets under UK and US GAAP, the difference in accounting for the merger with Astra represents substantially all of the adjustments.

### Results of continuing operations (US GAAP)

#### 2004 compared with 2003

Sales increased to \$21,426 million in 2004 from \$18,849 million in 2003. Improvements in revenues from growth products exceeded the declines in expiry products whilst base products remained flat resulting in an underlying 9% increase in sales. These higher sales together with higher other income (including the gain from the sale of Advanta) more than compensated for the increased levels of costs resulting in net income before tax improving from \$3,233 million in 2003 to \$3,932 million in 2004. Earnings per share rose from \$1.33 in 2003 to \$1.82 in 2004.

The annual impairment tests on our US GAAP goodwill balances resulted in no impairments at 31 December 2004.

#### 2003 compared with 2002

Sales from continuing operations rose from \$17,841 million to \$18,849 million. Strong performances from key growth and launch products, together with exchange effects, compensated for lost sales from patent

expired products. Net income and earnings per share were largely unchanged from 2002 at \$2,268 million and \$1.33, respectively. Higher amortisation and share-based payment charges and lower gains from deferred income and derivative financial instruments were offset by lower tax and the absence of the *Zoladex* exceptional costs.

Further details of the impact of the differences between UK GAAP and US GAAP are set out in the Additional Information for US Investors on pages 125 to 135.

### Taxation

Taxation in 2004 amounted to \$881 million, an effective rate of 22.4% compared to 29.8% in 2003.

The gain on the sale of Advanta together with tax relief of \$9 million on associated costs, tax credits on the *Zoladex* settlement and reversal of deferred tax on rolled over capital gains reduced the rate.

In 2003 the total taxation amounted to \$965 million compared to \$1,035 million, an effective rate of 30% compared to 31% in 2002.

### Cash flow

Operating activities contributed \$4,842 million cash in 2004, an increase of \$1,426 million over 2003. This improvement was a reflection of improved profitability and working capital management countered by higher tax payments. The cash was utilised in increasing investing activities in short term and fixed deposits (\$862 million) together with capital expenditure and acquisition and disposals (net \$910 million, after receipts of \$355 million on Advanta and Durascan). Financing outflows remained at similar levels to 2003, but this was the net effect of new loan proceeds of \$725 million and increased returns to shareholders through share re-purchases and dividends totalling \$3,488 million.

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Operating activities in 2003 resulted in a cash inflow of \$3,416 million, down from \$4,833 million in 2002. Working capital increases and exceptional item costs (primarily the *Zoladex* investigation settlement) were the main reasons behind the decline. Total cash outflow in respect of investing activities was \$746 million; inflows from liquidation of short term investments of \$771 million and the sale of Marlow Foods reduced the costs of fixed asset investing of \$1,597 million. The financing outflows represented absorption of funds in respect of dividends (\$1,222 million), share re-purchases (\$1,107 million) and loan repayments of \$345 million.

In 2002, operating activities produced cash inflows of \$4,833 million after tax outflows of \$795 million and interest inflows of \$46 million. There was a cash outflow in respect of investing activities of \$2,349 million, reflecting further investment in short term investments and fixed deposits. Financing cash outflows absorbed \$2,506 million through the share re-purchase programme (\$1,154 million) and dividends (\$1,234 million).

### Net assets

Under US GAAP, net assets are significantly higher than under UK GAAP because the merger between Astra and Zeneca has been regarded as a purchase of Astra. Goodwill on the acquisition of Astra amounted to \$15.1 billion (up from the 2003 balance of \$14.3 billion due to exchange) whilst adjustments to fixed assets (both tangible and intangible) fell through depreciation and amortisation from \$7.7 billion to \$7.0 billion. Under US GAAP, our net assets totalled \$35.3 billion at 31 December 2004 and comprised of \$17.4 billion fixed assets, \$16.1 billion goodwill and \$13.7 billion current assets whilst total liabilities amounted to \$12.1 billion.

### Income, shareholders equity and cash flow under US GAAP

	2004 \$m	2003 \$m	2002 \$m
Operating income	3,932	3,233	3,342
Net income for the year	3,051	2,268	2,307
Shareholders equity	35,314	33,654	30,183
Increase/(decrease) in cash	309	(4)	(22)



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Directors Report

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## Directors Report

AstraZeneca PLC is the holding company for a group of subsidiaries whose principal activities are described in the Operational and Financial Reviews on pages 11 to 51, which are incorporated in this report by reference. Principal subsidiaries and their locations are given on page 124.

The Company's dividend for 2004 of \$0.94 (50.3 pence, SEK 6.697) per Ordinary Share amounts to a total dividend payment to shareholders of \$1,555 million.

In view of the Company's resources, results of operations and overall financial condition, the Directors continue to adopt the going concern basis in preparing the Financial Statements.

Changes in the Company's Ordinary Share capital during 2004, including details of the allotment of new shares under the Company's share plans, are given in Note 29 to the Financial Statements.

### Board of Directors

Details of members of the Board at 31 December 2004 are set out on pages 8 and 9.

The Board held six scheduled meetings during 2004. Four of the Board meetings were held in London, UK. One meeting was held in the US and one in Sweden. Each meeting was attended by all of its members except that John Buchanan was unable to attend the October meeting, Joe Jimenez was unable to attend the December meeting and Louis Schweitzer was unable to attend either of those meetings due to other commitments. The Board is currently scheduled to meet six times in 2005.

### Board changes

Percy Barnevik, Non-Executive Chairman, retired from the Board on 31 December 2004

Louis Schweitzer was appointed Non-Executive Chairman with effect from 1 January 2005. Mr Schweitzer was first appointed to the Board in March 2004 and was elected as a Non-Executive Director for the first time by shareholders at the Annual General Meeting (AGM) in April 2004.

Also with effect from 1 January 2005, John Patterson was appointed as an Executive Director with responsibility for Development.

Karl von der Heyden, Non-Executive Director and Chairman of the Audit Committee, retired from the Board in April 2004, with effect from the end of the AGM. He was succeeded in his role as Chairman

of the Audit Committee by John Buchanan, Non-Executive Director.

During 2004, Michele Hooper and Joe Jimenez, both Non-Executive Directors, became members of the Audit Committee and Remuneration Committee, respectively.

In March 2004, the Board asked Sir Tom McKillop to extend his term as Chief Executive beyond his planned retirement date of March 2005 and he confirmed his willingness to do so.

### Election and re-election of Directors

All of the Directors will retire under Article 65 of the Company's Articles of Association at the AGM in April 2005. The Notice of AGM will give details of those Directors presenting themselves for election or re-election at the AGM.

## Mandatory shareholding for Directors

The Company's Articles of Association require each Director to be the beneficial owner of Ordinary Shares in the Company with an aggregate nominal value of \$125 (500 shares). Such holding must be obtained within two months of the date of the Director's appointment. At 31 December 2004, all of the Directors complied with this requirement and full details of each Director's interests in shares of the Company are set out in the Directors' Remuneration Report on pages 60 to 68.

## Annual General Meeting

The Company's AGM will be held on 28 April 2005. The principal meeting place will be in London. There will be a simultaneous satellite meeting in Stockholm.

## Corporate governance

### UK Combined Code on Corporate Governance

In July 2003, the Financial Reporting Council in the UK issued the revised Combined Code on Corporate Governance which superseded and replaced the Combined Code published by the Hampel Committee on Corporate Governance in 1998. The Board has prepared this report with reference to the Combined Code.

The Company is applying all of the main and supporting principles of good governance in the Combined Code. The way in which these principles are being applied is described below.

The Company is complying with all of the provisions of the Combined Code except with

regard to the independence of all members of the Audit Committee, as explained below in relation to Marcus Wallenberg.

### The US Sarbanes-Oxley Act of 2002

AstraZeneca PLC American Depositary Shares are traded on the New York Stock Exchange (NYSE) and the Company is subject to the reporting and other requirements of the US Securities and Exchange Commission (SEC) applicable to foreign issuers. The US Sarbanes-Oxley Act came into force at the end of July 2002. As a result of its NYSE listing, the Company is subject to those provisions of the Act applicable to foreign issuers.

The Company either already complies with or will comply with those provisions of the Act applicable to foreign issuers as and when they become effective. The Board believes that, prior to the Act coming into force, the Company already had a sound corporate governance framework, good processes for the accurate and timely reporting of its financial position and results of operations and an effective and robust system of internal controls. Consequently, the Company's approach to compliance with the Act has principally involved the development and adjustment of its existing corporate governance framework and associated processes concerning reporting, internal controls and other relevant matters.

The principal area of work relevant to the Act undertaken in the last 12 months was continuing preparations to enable the Company to comply in due course with the SEC rules which implement section 404 of the Act. These provisions become effective for the Company in 2005. Following the implementation of this section of the Act, the management of companies will be required to state its responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting and annually assess the effectiveness of that structure and those procedures. The external auditor will be required to attest to and report on management's assessment. More information about the section 404 work carried out during 2004 is set out in the Financial Review on page 48.

### The New York Stock Exchange

The Company, as a foreign issuer with American Depositary Shares listed on the NYSE, is generally obliged to disclose any significant ways in which its corporate governance practices differ from the NYSE's corporate governance listing standards. The exception to this is that

the Company must comply fully with the provisions of the listing standards which relate to the composition, responsibilities and operation of audit committees. These provisions incorporate the rules concerning audit committees implemented by the SEC under the US Sarbanes-Oxley Act of 2002.

The Company has reviewed the NYSE's corporate governance listing standards. Its corporate governance practices are generally consistent with those standards. However, while the Company's Non-Executive Directors do meet without the Executive Directors present, these meetings have not been specifically pre-scheduled.

The Company's Audit Committee complies with the provisions of the listing standards which relate to the composition, responsibilities and operation of audit committees. Marcus Wallenberg, a Non-Executive Director and a member of the Audit Committee, although not independent under the UK Combined Code, is independent under the criteria of the NYSE's listing standards concerning the composition of audit committees. More detailed information about the Audit Committee and its work during 2004 are set out in the Audit Committee's Report on pages 58 to 59.

### Disclosure Policy and Disclosure Committee

In January 2004, the Board approved a revised version of the Company's Disclosure Policy, which provides a framework for the handling and disclosure of price sensitive and other information and defines the role of the Disclosure Committee. The Chief Financial Officer, the Group Secretary and Solicitor and the Vice-President, Corporate Affairs were the members of the Disclosure Committee during 2004. With effect from 1 January 2005, John Patterson, Executive Director, Development, became a member of the Disclosure Committee. The Disclosure Committee meets regularly to assist and inform the decisions of the Chief Executive concerning price sensitive information and its disclosure. Periodically, it reviews the Company's disclosure controls and procedures and the operation of the Disclosure Committee as part of work carried out to enable management and the Board to assure themselves that appropriate processes are operating for the Company's planned disclosures, such as its quarterly results announcements and scheduled investor relations events. In addition, the Disclosure Committee reviews the process for preparing and drafts of the Company's Annual Report and Form 20-F Information.

Recognising the importance to shareholders and the investment community of news about certain of the Company's key development and marketed products, much of the Disclosure Committee's work in 2004 focused on ensuring that accurate, complete and timely disclosures were made concerning *Exanta*, *Crestor* and *Iressa*. Throughout 2004, as well as frequent ad hoc meetings to review specific disclosure issues, the Disclosure Committee met monthly to review a rolling schedule of key news concerning the Company and its products. The schedule was subsequently reviewed on a monthly basis by the Senior Executive Team.

## Board structure and processes

### Board composition, responsibilities and appointments

The Board comprises Executive and Non-Executive Directors. In the view of the Board, the majority of Board members excluding the Chairman are independent Non-Executive Directors. The differing roles of Executive Directors and Non-Executive Directors are clearly delineated, with both having fiduciary duties towards shareholders and all being collectively responsible for the success of the Company. However, Executive Directors have direct responsibility for business operations, whereas the Non-Executive Directors have a responsibility to bring independent, objective judgement to bear on Board decisions. This includes constructively challenging management and helping to develop the Company's strategy. The Non-Executive Directors scrutinise the performance of management and have various responsibilities concerning the integrity of financial information, internal controls and risk management. To help maintain a strong executive presence on the Board in addition to the Executive Directors, Board meetings are attended by two members of the Senior Executive Team on a rotational basis.

The Board sets the Company's strategy and policies and monitors progress towards meeting its objectives. It also assesses whether its obligations to the Company's shareholders and others are understood and met. This includes regular reviews of the Company's financial performance and critical business issues.

There is an established and transparent procedure for appointments of new directors to the Board which is operated by the Nomination Committee. All of the Directors retire at each AGM and may offer themselves for re-election by shareholders. The

## Board

reviews annually the status of succession to senior positions, including those at Board level, and ensures it has regular contact with, and access to, succession candidates.

At its meeting in December 2004, the Board conducted its annual review and assessment of how it operates. This was done without external facilitation and included consideration and discussion of the nature and level of its interaction with the Company's management; the quality, quantity and coverage of information which flows to the Board from management; the balance of the Board's time spent considering strategic issues compared to other matters; the content of Board meetings and presentations to Board meetings; the composition of the Board; the practical arrangements for the work of the Board; and the work and operation of the Board's committees. Overall, Board members concluded that the Board and its committees were operating in an effective and constructive manner.

At the same meeting, the Chairman also reported to the Board on his conversations with each Non-Executive Director about their individual performance and that of the Board as a whole, which took place during the fourth quarter of 2004. As the Chairman's retirement was imminent, no formal review of his performance was conducted. The Non-Executive Directors reviewed the performance of the Chief Executive and the Chief Financial Officer in their absence.

In April 2004, a number of the Non-Executive Directors (including the Chairman, the senior Non-Executive Director and Louis Schweitzer) attended a seminar organised by the Company covering the roles and responsibilities of directors of UK listed companies.

The Company maintained directors' and officers' liability insurance cover throughout 2004.

### **Independence of Directors under the UK Combined Code**

During 2004, the Board considered the independence of each Non-Executive Director. With the exception of two of them (as set out below) and the Chairman, the Board considers that all of the Non-Executive Directors are independent in character and judgement and that there are no relationships or circumstances which are likely to affect their independent judgement. The Board also considers that Louis Schweitzer, who was appointed Non-Executive Chairman with effect from

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Directors Report

## Directors Report continued

1 January 2005, was independent on appointment.

For the reasons explained below, the Board does not believe that Håkan Mogren, Non-Executive Deputy Chairman, or Marcus Wallenberg can be determined independent under the revised Combined Code. However, the Board believes that both Dr Mogren and Mr Wallenberg bring considerable business experience and make valuable contributions to the work of the Board and, in Mr Wallenberg's case, the Audit Committee.

Dr Mogren was previously the Chief Executive Officer of Astra AB and Executive Deputy Chairman of the Company. Both Dr Mogren and Mr Wallenberg are members of the Board of Directors of Investor AB, a company which, at 31 December 2004, held approximately 4% of the Ordinary Shares of the Company. This holding represents a significant proportion of Investor AB's overall investment portfolio. Additionally, Mr Wallenberg is the Chief Executive Officer of Investor AB.

The Board also considered, in particular, the positions of Sir Peter Bonfield, senior Non-Executive Director, Erna Möller and Jane Henney. For the reasons explained below, it is the Board's view that they are independent. They discharge their duties in a properly independent manner and constructively and appropriately challenge the Executive Directors and the Board.

Sir Peter is a Non-Executive Director of Telefonaktiebolaget LM Ericsson. Marcus Wallenberg is also a Non-Executive Director of Ericsson. Investor AB, of which Mr Wallenberg is Chief Executive Officer, holds approximately 5% of Ericsson's shares (representing approximately 19% of the voting rights). The Board is satisfied that Sir Peter's presence on the Ericsson Board results from his broad experience of the global telecommunications industry and not from any connection with Investor AB or the Wallenberg family. The Board also had regard to the length of time which Sir Peter has served as a Non-Executive Director of the Company (he was first appointed in 1995).

As the position was only established in 2002, the Board wishes Sir Peter to continue in his current role as the senior Non-Executive Director of the Company for one or two years more to provide further continuity, subject to his re-election at Annual General Meetings.

Professor Möller is the Chief Executive Officer of the Board of the Knut and Alice

Wallenberg Foundation, a charitable foundation in Sweden that supports scientific research and educational programmes by awarding financial grants to individuals or institutions. Although one of the Foundation's principal investments is in Investor AB, all investment decisions of the Foundation are made by its investment committee, of which Professor Möller is not a member. Her role, as Chief Executive Officer of the Board, is principally to lead the scrutiny of applications for grants and maintain close contacts with scientific and educational institutions in Sweden to develop the work of the Foundation.

Jane Henney is a Non-Executive Director of AmerisourceBergen Corporation and CIGNA Corporation, both of which are customers of the Company in the US. The Board considered these relationships and concluded that they did not compromise her independence.

### Chief Executive and the Senior Executive Team

The Chief Executive, Sir Tom McKillop, has delegated authority from, and is responsible to, the Board for directing and promoting the profitable operation and development of the Company, consistent with the primary aim of enhancing long term shareholder value.

The Chief Executive is responsible to the Board for the management and performance of the Company's businesses within the framework of Company policies, reserved powers and routine reporting requirements. He is obliged to refer certain major matters (defined in the formal delegation of the Board's authority) back to the Board. The roles of the Board, the Board's committees, the Chairman, the Chief Executive and the Senior Executive Team are documented, as are the Company's delegated authorities and

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reserved powers, the means of operation of the business and the roles of corporate functions.

The Chief Executive has established and chairs the Senior Executive Team. While the Chief Executive retains full responsibility for the authority delegated to him by the Board, the Senior Executive Team is the vehicle through which he exercises that authority in respect of the Company's business (including Salick Health Care and Astra Tech).

The members of the Senior Executive Team are Jonathan Symonds, Chief Financial Officer; John Patterson, Executive Director, Development; Bruno Angelici, Executive Vice-President, Europe, Japan, Asia Pacific and ROW; David Brennan, Executive Vice-

President, North America; Jan Lundberg, Executive Vice-President, Discovery Research; Martin Nicklasson, Executive Vice-President, Product Strategy & Licensing and Business Development; Barrie Thorpe, Executive Vice-President, Operations; and Tony Bloxham, Executive Vice-President, Human Resources.

The Senior Executive Team normally meets once a month to consider and decide all major business issues. It also usually reviews those matters that are of a size or importance to require the attention of, or that are reserved to, the Board before such matters are submitted to the Board for review and decision.

Each business function is subject to an annual budget and target-setting process, including forecasts for the following two years together with a sensitivity and risk analysis, quarterly updates of the forecast for the current year and regular reporting.

Performance reviews are undertaken in each part of the business regularly. The Company's quarterly business performance management system uses a broad range of measures that link directly to the achievement of key business priorities. Treasury operations are centralised, operate within defined limits and are subject to regular reporting requirements and Audit Committee reviews.

### Internal controls and management of risk

The Board has overall responsibility for the Company's system of internal controls, which aims to safeguard shareholders investments and the Company's assets, and to ensure that proper accounting records are maintained and that the financial information used within the business and for publication is accurate, reliable and fairly presents the financial position of the Company and the results of its business operations. The Board is also responsible for reviewing the effectiveness of the system of internal controls. The system is designed to provide reasonable assurance of effective operations and compliance with laws and regulations, although any system of internal controls can only provide reasonable, not absolute, assurance against material misstatement or loss.

Since the publication in September 1999 by the Institute of Chartered Accountants in England and Wales of the Turnbull Report, Internal Control: Guidance for Directors on the Combined Code, the Directors have continued to review the effectiveness of the

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Directors Report

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Group's system of controls, including operational and compliance controls, risk management and the Company's high level internal control arrangements. These reviews have included an assessment of internal controls, and in particular internal financial controls, by the internal audit function, management assurance of the maintenance of control and reports from the external auditor on matters identified in the course of its statutory audit work.

A key part of these reviews is an annual letter of assurance process by which responsible managers confirm the adequacy of their systems of internal financial and non-financial controls, their compliance with Company policies (including those relating to safety, health and the environment) and local laws and regulations (including the industry's regulatory requirements), and confirm they have reported any control weaknesses identified in the past year. During 2004, the Company introduced continuous assurance processes which operate throughout the year and are intended to keep senior management informed, on a rolling basis, of the state of internal controls, any particular issues which have developed and the progress of any remediation work. While the annual letter of assurance process has been retained, the year-round continuous assurance processes are intended to make the annual letter of assurance process more efficient and to improve senior management's visibility of the operation of internal controls.

The Directors believe that the Company maintains an effective, embedded system of internal controls and complies with the Turnbull Report guidance.

The Company views the careful management of risk as a key management activity. Through the adoption by the Board of a Group Risk & Control Policy and supporting standards, the Company aims to formalise the drive to manage business risks as a key element of all activities. These business risks, which may be strategic, operational, reputational, financial or environmental, should be understood and visible to all managers using a simple and flexible framework. The business context determines in each situation the level of acceptable risk and controls, and managers are challenged to recognise and assess this actively and clearly.

Much of the Company's work in the area of risk management is facilitated by the Risk Advisory Group, consisting of

representatives from each business function. Its role continues to be advisory and is to assist senior management to identify and assess the main risks faced by the Company's business in a co-ordinated manner; to assess and document the Company's risk profile; and to ensure that the business focuses on critical business issues. It is chaired by the Chief Financial Officer and reports twice a year to the Senior Executive Team. The Risk Advisory Group's reports on the Company's risk profile are reviewed by both the Audit Committee and the Board.

The Company's policy remains to embed an integrated risk management framework with the aim of continuing to ensure that the business understands the key risks it faces. The focus of the Risk Advisory Group is, in particular, on cross-functional risks, linking risk management to business performance reporting and seeking continuous improvement in the management of risk by sharing best practice throughout the organisation.

### Code of Conduct

The policy of the Company is to require all of its subsidiaries, and their employees, to observe the highest ethical standards of integrity and honesty and to act with due skill, care, diligence and fairness in the conduct of business. The Company's management recognises that such standards make a significant contribution to the overall control environment and seeks, by its words and actions, to reinforce them throughout the business. In particular, all employees are required to comply with the letter and spirit of the AstraZeneca Code of Conduct and with the high ethical standards detailed by the Company in support of it.

The AstraZeneca Code of Conduct is set out in full on pages 158 and 159. It is an important demonstration of the Company's uncompromising commitment to honesty and integrity. The Company maintains procedures for raising integrity concerns, which include a confidential helpline for employees worldwide. During 2004, the confidential helpline was used by employees to seek guidance on corporate responsibility issues or to raise concerns, all of which were fully reviewed and a report sent to the Audit Committee. To date, no material issues have been identified through this route.

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The Company also has a Finance Code of Conduct which complements the main AstraZeneca Code of Conduct and applies to the Chief Executive, the Chief Financial Officer and the Company's principal

accounting officers. The Finance Code of Conduct also applies to all Finance function employees and reinforces the importance of the integrity of the Company's accounts, the reliability of the accounting records on which they are based and the robustness of the relevant controls and processes.

During 2004, the Senior Executive Team sponsored a review and re-structuring of the Company's full range of policies, standards and guidelines to ensure the hierarchy and content are clear and appropriate for ensuring people's understanding of what is expected of them at every level in the business. Following formal Board approval early in 2005, the new Group policies will be made available on a dedicated intranet site, the availability and purpose of which will be widely communicated throughout the organisation.

### **Group Internal Audit**

Group Internal Audit (GIA) is an independent appraisal function that derives its authority from the Board through the Audit Committee. Its primary role is to provide reasonable and objective assurance about the adequacy and effectiveness of the Company's financial control framework, compliance with laws, regulations and policies and risk management processes.

GIA seeks to discharge the responsibilities set down in its charter by reviewing the processes which ensure that business risks are effectively managed; reviewing the financial and operational controls that help to ensure that the Company's assets are properly safeguarded from losses, including fraud; reviewing the controls that help to ensure the reliability and integrity of management information systems; reviewing the processes that ensure compliance with policies and procedures and external legislation and regulation (other than those relating to safety, health and the environment and product regulatory compliance, which are the responsibility of other audit functions); and, on an ad hoc basis, reviewing whether value for money is obtained.

GIA also acts as a source of constructive advice and best practice, assisting senior management with its responsibility to improve the processes by which risks are identified and managed and to report and advise on the proper and effective use of resources.

### **External auditor**

A resolution will be proposed at the AGM on 28 April 2005 for the re-appointment of

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Directors Report

## Directors Report continued

KPMG Audit Plc, London as auditor of the Company.

The external auditor has undertaken various pieces of non-audit work for the Company during 2004. More information about this work and the audit and non-audit fees paid by the Company are set out in Note 32 to the Financial Statements on page 119. The external auditor is not engaged by the Company to carry out any non-audit work on which it might, in the future, be required to express an audit opinion. As explained more fully in the Audit Committee's Report on pages 58 to 59, the Audit Committee has established pre-approval policies and procedures for audit and non-audit work permitted to be carried out by the external auditor and has carefully monitored the objectivity and independence of the external auditor throughout 2004.

### Board committees

#### Audit Committee

Full details about the Audit Committee, its composition, remit and work during 2004 can be found in the Audit Committee's Report on pages 58 to 59.

#### Remuneration Committee

The members of the Remuneration

Committee are Sir Peter Bonfield (Chairman of the Committee), John Buchanan, Erna Möller and Joe Jimenez. Mr Jimenez was appointed as a member of the Remuneration Committee with effect from the end of the AGM in April 2004. They are all Non-Executive Directors. The Board considers them all to be independent.

The remit of the Remuneration Committee is, primarily, to recommend for decision by the Board the fundamental remuneration policy for the Company and to ensure the proper operation of all plans for employees involving the Company's shares. More particularly, it makes specific proposals in respect of the remuneration packages of individual Executive Directors and the Company's most senior executives.

Further information about the membership and work of the Remuneration Committee and the Company's remuneration policy and practice is set out in the Directors' Remuneration Report on pages 60 to 68.

#### Nomination Committee

The members of the Nomination Committee during 2004 were Percy Barnevik (Chairman of the Committee), Håkan Mogren, Sir Peter Bonfield, Jane Henney and Joe Jimenez. With effect from 1 January 2005, Louis Schweitzer, Non-Executive Chairman,

became Chairman of the Nomination Committee in Percy Barnevik's stead. All of the current members of the Nomination Committee are Non-Executive Directors. With the exception of the Chairman and Dr Mogren (for the reasons explained above), the Board considers them all to be independent.

The remit of the Nomination Committee is, primarily, to lead the process for, and to make proposals to the Board for, any new appointments as Directors of the Company. The remit of the Nomination Committee is available on the Company's website: [astrazeneca.com](http://astrazeneca.com). The principal task in relation to nomination matters in 2004 related to the appointment of a new Non-Executive Director, Louis Schweitzer, who could subsequently become Chairman of the Board. In the light of this, the Board felt the appointment process should not be led by the Nomination Committee, which is chaired by the Chairman. Accordingly, a committee of Non-Executive Directors chaired by Sir Peter Bonfield, senior Non-Executive Director, led the process for the appointment of Mr Schweitzer, which was supported by external search consultants.

As with all new Non-Executive Directors, a series of induction meetings with various senior managers was arranged for Mr Schweitzer following his appointment to the Board. This included his attendance at a meeting of the Senior Executive Team over two days in November 2004.

#### Science Committee

The members of the Science Committee are Jane Henney, Erna Möller and Dame Bridget Ogilvie. They are all Non-Executive

Directors.

The remit of the Science Committee is, on behalf of the Board, to review and assess the international competitiveness and quality of science within the Company. The Executive Vice-President, Discovery Research and the Chief Scientist and Head of Project Evaluation normally attend meetings of the Science Committee.

## Shareholders

In its financial reporting to shareholders and other interested parties by means of annual and quarterly reports, the Board aims to present a balanced and understandable assessment of the Company's financial position and prospects.

The Company maintains a corporate website containing a wide range of information of interest to institutional and private investors: [astrazeneca.com](http://astrazeneca.com).

The Company has frequent discussions with institutional shareholders on a range of issues affecting its performance. These include meetings following the announcement of the annual results with the Company's largest institutional shareholders on an individual basis. In addition, the Company responds to individual ad hoc requests for discussions from institutional shareholders. The senior Non-Executive Director is available to shareholders if they have concerns which contact through the normal channels of Chairman, Chief Executive or Chief Financial Officer has failed to resolve, or for which such contact is inappropriate.

All shareholders, including private investors, have an opportunity at the AGM to put questions to members of the Board on matters relating to the Company's operation and performance.

## Employees

The core values of the Company are respect for the individual and diversity; openness, honesty, trust and support for each other; integrity and high ethical standards; and leadership by example at all levels.

The Company maintains an open management style and involves its employees both in daily decisions which affect them and longer term matters. The Company is fully committed to keeping all of its employees informed about their work unit and the wider business, as well as discussing the implications of major business changes and other relevant matters. Key business priorities are communicated throughout the organisation and form part of the basis for the Company's employee bonus and incentive plans. Details of employees' share plans appear in Note 29 to the Financial Statements.

In line with legal requirements and cultural standards, more formal national and business level employee consultation arrangements exist in some countries, including the UK. There is a forum for employee consultation at European level, chaired by the Chief Executive, in which employee representatives from 19 countries participate. The Company also has a variety of constructive relationships with trade unions across its worldwide operations, including formal recognition and active dialogue where appropriate.

The Company believes that every employee should be treated with the same respect and dignity. It values the rich diversity and

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creative potential of people with differing backgrounds and abilities and encourages a culture of equal opportunities, in which personal success depends on personal merit and performance. It is Company policy that there should be no discrimination against any person for any reason. All judgements about people for the purposes of recruitment, development and promotion are made solely on the basis of their ability and potential in relation to the needs of the job. Every manager is responsible for implementing this policy.

It is Company policy that people with disabilities should have the same consideration as others with respect to recruitment, retention and personal development. Depending on their skills and abilities, people with disabilities enjoy the same career prospects as other employees and the same scope for realising potential. The Company also takes all reasonable steps to ensure that its working environments can accommodate special needs.

### Corporate responsibility

The Company aims to set, promote and maintain high standards of corporate responsibility wherever it operates. Dame Bridget Ogilvie, Non-Executive Director, is the Board member responsible for this area and oversees the work of a cross-functional, global corporate responsibility committee. The Company continues to develop its established systems for monitoring performance. Policies and standards relating to corporate responsibility are maintained and widely communicated within the organisation. In 2004, the Company was again included in the FTSE4Good and the Dow Jones Sustainability World indices. Increasing competition for places in the Dow Jones STOXX (European) Index meant the Company lost its place in that index in 2004. The Company publishes and sends to shareholders a separate Corporate Responsibility Summary Report. For the first time, information in the Corporate Responsibility Summary Report for 2004 will be subject to an assurance process carried out by an independent, third party organisation. More detailed information about the Company's approach to corporate responsibility can be found on its website: [astrazeneca.com](http://astrazeneca.com).

It is not Company policy formally to comply with the Confederation of British Industry's code of practice on the prompt payment of suppliers. It is, however, Company policy to agree appropriate payment terms with all suppliers when agreeing the terms of each

transaction, to ensure that those suppliers are made aware of the terms of payment and, subject to their compliance, abide by the terms of payment. The total amount of money owed by the Company's subsidiaries to trade creditors at the balance sheet date was equivalent to 74 days' average purchases. No equivalent disclosure is provided in respect of the Company as it has no external creditors.

### Purchase of own shares

The Company's stated distribution policy contains both a regular dividend cash flow and a share re-purchase component to give the Company more flexibility in managing its capital structure over time. In August 1999, the Company announced a \$2 billion share re-purchase programme to be completed by the end of 2002. This programme was completed ahead of schedule in the second quarter of 2002. In January 2002, the Company announced an additional \$2 billion re-purchase programme which was completed on schedule by the end of 2003. In January 2004, the Board approved a further \$4 billion re-purchase programme to be completed by the end of 2005.

The Board keeps under continuous review its shareholders' return strategy and restates its intention to grow dividends in line with earnings while maintaining dividend cover in the two to three times range. The Board also believes that the share re-purchase programme is a key part of shareholder return that addresses cash flow and potentially surplus capital. In the absence of strategic uses for cash, the Board expects to distribute the free cash flow generated over the next three years through dividends and share re-purchases.

During 2004, the Company purchased 50.1 million of its own Ordinary Shares with a nominal value of \$0.25 each for an aggregate cost of \$2,212 million. Following the purchase of these shares, they were all cancelled. This number of shares represents 3.0% of the Company's total issued share capital at 31 December 2004.

Since the beginning of the original re-purchase programme in 1999, the Company has purchased for cancellation in total 142.9 million of its own Ordinary Shares with a nominal value of \$0.25 each for an aggregate cost of \$6,171 million. This number of shares represents 8.7% of the Company's total issued share capital at 31 December 2004.

The Company continues to maintain robust controls in respect of all aspects of the

share re-purchase programme to ensure compliance with English law and the Listing Rules of the UK Listing Authority. In particular, the Company's Disclosure Committee meets to ensure that the Company does not purchase its own shares during prohibited periods. At the AGM on 28 April 2005, the Company will seek a renewal of its current permission from shareholders to purchase its own shares.

### Political donations

Under the UK's Political Parties, Elections and Referendums Act 2000, shareholder authority is required for political donations to be made or political expenditure to be incurred by the Company or its subsidiaries in the European Union. Neither the Company nor its subsidiaries made any donations or incurred any expenditure in 2004 in the European Union in respect of which shareholder authority or disclosure in this Directors' Report is required under the Act. Neither the Company nor its subsidiaries intend to make any such donations or incur any such expenditure in the European Union in the foreseeable future. However, the Act defines political organisation widely and, for example, interest groups or lobbying organisations concerned with the review of government policy or law reform may be caught by the definition.

To enable the Company to continue to support such organisations without inadvertently breaching the Act, a resolution will, in the same way as last year, be proposed at the AGM on 28 April 2005 authorising the Company to make donations or incur expenditure in the European Union up to an aggregate limit of \$150,000.

In 2004, AstraZeneca's US legal entities made contributions amounting in aggregate to \$323,000 (2003 \$258,000) to state political party committees and to campaign committees of various state candidates affiliated with the major parties. All contributions were made only where allowed by state law. American nationals (those with valid green cards) exercised decision-making over the contributions and the funds were not provided or reimbursed by any non-US legal entity.

**On behalf of the Board**  
**G H R Musker**  
**Group Secretary and Solicitor**  
**27 January 2005**

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## Audit Committee's Report

The members of the Audit Committee are John Buchanan (Chairman of the Committee), Jane Henney, Dame Bridget Ogilvie, Marcus Wallenberg and Michele Hooper. Dr Buchanan succeeded Karl von der Heyden as Chairman of the Audit Committee following Mr von der Heyden's retirement from the Board in April 2004. Ms Hooper was appointed as a member of the Audit Committee with effect from the end of the AGM in April 2004. They are all Non-Executive Directors. With the exception of Mr Wallenberg for the reasons explained in the Directors' Report, the Board considers them all to be independent under the UK Combined Code. Marcus Wallenberg, although not independent under the UK Combined Code, is independent under the criteria of the NYSE's corporate governance listing standards concerning the composition of audit committees.

The Board remains satisfied that various members of the Audit Committee have recent and relevant financial experience. At its meeting in December 2004, the Board determined that Dr Buchanan and Ms Hooper are audit committee financial experts for the purposes of the US Sarbanes-Oxley Act of 2002.

The core remit of the Audit Committee is to review and report to the Board on:

- > The scope of and plans for audits of the Company by the external auditor and the internal audit function.
- > The implementation of the external and internal audit plans and the handling of any material issues arising from those audits.
- > The Company's overall framework for internal control over financial reporting and its financial reporting processes.
- > The Company's overall framework for other internal controls.
- > The Company's overall framework for risk management with particular emphasis on financial risks.
- > The accounting policies and practices of the Company.
- > The annual and quarterly financial reporting carried out by the Company.

The Audit Committee is also charged with promptly bringing to the attention of the Board:

- > Any significant concerns of the external auditor about the conduct, results or overall outcome of the annual audit of the Company.
- > Any significant concerns of the Chief Internal Auditor about the conduct, results or outcome of internal audits.
- > Any matters which may significantly affect or impair the independence of the external auditor.
- > Any significant deficiencies or material weaknesses in the design or operation of the Company's internal control over financial reporting.
- > Any significant deficiencies or material weaknesses in the design or operation of the Company's other internal controls and any significant breaches of those internal controls.
- > Any serious issues of non-compliance.

The Audit Committee also oversees the establishment, implementation and maintenance of the Code of Conduct. It establishes procedures for the receipt and handling of complaints concerning accounting or audit matters. It also appoints and agrees the compensation for the external auditor subject, in each case, to the approval of the Company's shareholders at a general meeting and, if necessary, recommends to the Board that a resolution be proposed at a general meeting of the Company authorising the removal of the external auditor. Additionally, the Audit Committee reviews and approves the appointment and any dismissal of the Chief Internal Auditor.

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The Audit Committee maintains policies and procedures for the pre-approval of all audit services and permitted non-audit services undertaken by the external auditor. The principal purpose of these policies and procedures is to ensure that the independence of the external auditor is not impaired. In January 2004, the Audit Committee renewed its pre-approval policies and procedures. This covered three categories of work – audit services, audit-related services and tax services. The policies define the type of work which falls within each of these categories, as well as those non-audit services which the external auditor is prohibited from performing under the rules of the US SEC. The pre-approval procedures permit certain audit, audit-related and tax services to be

performed by the external auditor during the year, subject to fee limits agreed with the Audit Committee in advance. The Group Financial Controller and the Director of Group Tax monitor the status of all services being provided by the external auditor. The procedures also deal with the placing of non-audit work out for tender, where appropriate. Authority to approve work in excess of the pre-agreed fee limits is delegated to the Chairman of the Audit Committee in the first instance. Regular reports to the full Audit Committee are also provided for and, in practice, a standing agenda item at Audit Committee meetings covers the operation of the pre-approval procedures.

The full remit of the Audit Committee is available on the Company's website: [astrazeneca.com](http://astrazeneca.com).

The Audit Committee met six times in 2004. Each meeting was attended by all of its members except that Mr Wallenberg was unable to attend part of the December meeting due to a prior engagement. At the invitation of the Audit Committee, the Chairman of the Board, a Non-Executive Director, attended three of its meetings in 2004. The Audit Committee is currently scheduled to meet seven times in 2005. The minutes of Audit Committee meetings are circulated to all Board members.

During the year, in line with its normal practice, the Audit Committee also held a number of private meetings, without management present, with both the Company's Chief Internal Auditor and the lead partner from the Company's external audit firm. The purpose of these meetings was to facilitate free and open discussions between the Audit Committee members and the Chief Internal Auditor and the external lead audit partner separately from the main sessions of the Audit Committee, which were attended by the Chief Financial Officer and the Group Financial Controller.

During 2004, the business considered and discussed by the Audit Committee included:

- > The financial disclosures contained in the Company's annual and quarterly reports to shareholders and other interested parties.
  - > Various accounting matters, including the Company's critical accounting policies, raised by management and the external auditor in the context of the financial disclosures. Specific examples of areas reviewed by the Audit Committee included the reporting of the effect of wholesaler stock movements in
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the Company's financial disclosures, the implementation of Inventory Management Agreements with a number of wholesalers in the US, the handling of managed care rebates and product returns in the US, and the effect of currency exchange rates on the Company's financial statements.

- > Reports from the external auditor concerning its audit of the financial statements of the Company.
- > Reports from management on the Company's general risk profile and the assessment and management of risk.
- > Reports from management, the internal audit function and the external auditor on the effectiveness of the Company's system of internal controls and, in particular, internal financial controls. These included a review and discussion of the results of the Company's letter of assurance process for 2004 and reviews of quarterly activity reports from the internal audit function and the status of follow-up actions with management.
- > A report of calls made by employees to the Company's Code of Conduct helpline seeking guidance on corporate responsibility issues or raising concerns and the results of the reviews of these matters. To date, no material issues have been identified through this route.
- > A review of the Company's preparations for the adoption in 2005 of International Accounting Standards/International Financial Reporting Standards, including the approval of proposed changes to certain of the Company's accounting policies. The Audit Committee also reviewed and approved the Company's publication in October 2004 of its financial information for 2003 and the first half of 2004 re-stated in accordance with IAS/IFRS (subject to any subsequent changes made to the standards before adoption).
- > Continuing review of the Company's US sales and marketing compliance programme, including the five year Corporate Integrity Agreement between the Company and the Office of Inspector General for the US Department of Health and Human Services signed in 2003.
- > Proposals from the internal audit function and the external auditor about their audit programmes for 2004.
- > A review at the beginning of 2004 of the performance of the external auditor which resulted in the Audit Committee unanimously recommending that a resolution for the re-appointment of KPMG Audit Plc as the Company's external auditor be proposed to shareholders at the AGM in April 2004.
- > A review of the performance of the internal audit function and, in particular, recruitment and career development plans for internal audit staff.
- > A report from the Development function concerning the Company's clinical development programmes and the key risks managed by the drug safety and quality management teams within Development.
- > A report from the Director of Group Tax about the Company's approach to risk management in relation to taxation matters.
- > The amount of audit and non-audit fees of the external auditor. The Audit Committee was satisfied throughout the year that the objectivity and independence of the external auditor were not in any way impaired by either the nature of the non-audit work undertaken by the external auditor during the year, the level of non-audit fees charged for such work or any other facts or circumstances. Full details of the audit and non-audit fees for the year are disclosed in Note 32 to the Financial Statements.
- > The Company's continuing work to comply with the applicable provisions of the US Sarbanes-Oxley Act of 2002. The Audit Committee regularly reviewed, in particular, the Company's work to prepare for the implementation in 2005 of section 404 of

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the Act concerning internal control over financial reporting.

> A review and assessment of how the Audit Committee operates.

At the scheduled meeting of the Audit Committee held at the end of January 2005, the Chief Executive and the Chief Financial Officer presented to the Audit Committee their conclusions following the evaluation of the effectiveness of the Company's disclosure controls and procedures required by Item 15(a) of Form 20-F as at 31 December 2004. Based on their evaluation, the Chief Executive and the Chief Financial Officer concluded that, as at that date, the Company maintains an effective system of disclosure controls and procedures.

During 2004, the Company's US business and its facility at Dunkirk in France successfully implemented major new accounting software. Other than this, there was no change in the Company's internal control over financial reporting that occurred during the period covered by this Annual Report and Form 20-F Information that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**On behalf of the Audit Committee**

**Dr J G S Buchanan Non-Executive Director and Chairman of the Audit Committee**

**27 January 2005**

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Directors Remuneration Report

## Directors Remuneration Report

At the Annual General Meeting (AGM) on 28 April 2005, a resolution will be proposed to approve the Directors Remuneration Report.

### Remuneration Committee

The members of the Remuneration Committee are Sir Peter Bonfield (Chairman of the Committee), John Buchanan, Erna Möller and Joe Jimenez. Mr Jimenez was appointed as a member of the Remuneration Committee with effect from the end of the AGM on 29 April 2004. They are all Non-Executive Directors. The Board considers them all to be independent.

The remit of the Remuneration Committee is, primarily, to recommend for decision by the Board the fundamental remuneration policy for the Company and to ensure the proper operation of all plans for employees involving the Company's shares. More particularly, it makes specific proposals in respect of the remuneration packages of individual Executive Directors and the Company's most senior executives. A copy of the Remuneration Committee's remit is available on the Company's website: [astrazeneca.com](http://astrazeneca.com).

The Remuneration Committee met six times during 2004. Each meeting was attended by all of its members except that John Buchanan was unable to attend the September meeting and Joe Jimenez was unable to attend the December meeting due to other commitments. At the invitation of the Remuneration Committee, the Chairman of the Board, a Non-Executive Director, attended all of its meetings in 2004 except for those held in September and December.

At the request of the Remuneration Committee, Sir Tom McKillop, Chief Executive, Tony Bloxham, Executive Vice-President, Human Resources and Peter Brown, Vice-President, Global Compensation and Benefits, as well as the Secretary of the Remuneration Committee, Graeme Musker, attended all of its meetings in 2004, except when their own remuneration was being discussed. They provided advice and services which materially assisted the Remuneration Committee during the year. In doing so, Mr Brown drew on various sources of data concerning directors' and executives' salaries, bonus levels and other incentives including general pharmaceutical industry reports and surveys, as well as surveys specifically carried out for the Company.

These included certain surveys prepared for the Company by Towers Perrin. During 2004, Towers Perrin also provided global share plan administration services to the Company and consultancy services to the Company's US business.

In July 2004, Ms Carol Arrowsmith of Deloitte & Touche was appointed by the Remuneration Committee to provide it with independent advice on all matters being considered by it. During 2004, Deloitte & Touche also provided taxation advice and other non-audit services to the Company.

### Overall remuneration policy and purpose

The Company is committed to maintaining a dynamic performance culture in which every employee champions the growth of shareholder value, is clear about the Company's objectives, knows how their work impacts on those objectives and that they will benefit from achieving high levels of performance.

The Board has confirmed that the Company's overall remuneration policy and purpose is:

- > To attract and retain people of the quality necessary to sustain the Company as one of the best pharmaceutical companies in the world.
- > To motivate them to achieve the level of performance necessary to create sustained growth in shareholder value.

In order to achieve this, remuneration policy and practice is designed:

- > To closely align individual and team reward with business performance at each level.
- > To encourage employees to perform to their fullest capacity.

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- > To encourage employees to align their interests with those of shareholders.
- > To support managers' responsibility to achieve business performance through people and for them to recognise superior performance, in the short and longer term.
- > To be as locally focused and flexible as is practicable and beneficial.
- > To be competitive and cost-effective in each of the relevant employment markets.
- > To be as internally consistent as is practicable and beneficial taking due account of market need.

The cost and value of the components of the remuneration package are considered as a whole and are designed:

- > To ensure a proper balance of fixed and variable performance-related components, linked to short and longer term objectives.
- > To reflect market competitiveness taking account of the total value of all of the benefit components.

Throughout 2004, the principal components contained in the total remuneration package, for employees as a whole, were:

- > Annual salary based on conditions in the relevant geographic market, with the provision to recognise, in addition, the value of individuals' sustained personal performance, resulting from their ability and experience.
- > Annual bonus a lump sum payment related to the targeted achievement of corporate, functional and individual goals, measured over a year and contained within a specific plan. The corporate goals are derived from the annual financial targets set by the Board and take into account external expectations of performance. The functional goals are agreed by the Remuneration Committee at the start of, and are monitored throughout, the year.
- > Longer term incentive for selected groups, a longer term incentive targeted at the achievement of strategic objectives with close alignment to the interests of shareholders.
- > Pension arrangements which are appropriate to the relevant national market.
- > Other benefits such as holidays and sickness benefit which are cost-effective and compatible with the relevant national welfare arrangements.
- > Share participation various plans provide the opportunity for employees to take a personal stake in the Company's wealth creation as shareholders.

The way in which these elements are combined and applied varies depending, for example, on market need and practice in various countries.

In 2004, for each Executive Director, the individual components were:

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- > Annual salary the actual salary for each of the Executive Directors is determined by the Remuneration Committee on behalf of the Board and established in sterling. These salaries reflect the experience and sustained performance of the individuals to whom they apply, as judged annually by the Remuneration Committee, taking account also of market competitiveness and the level of increases applicable to all other employees.
- > Short term bonus:
  - > The Chief Executive was eligible for an annual bonus related solely to the achievement of the targeted performance of earnings per share. The bonus payable was on a scale of 0-100% of salary and 50% of salary was payable for the achievement of target performance. This was derived from the financial targets set by the Board and took into account external expectations of performance. The bonus was not pensionable. In the light of the disappointing setbacks with *Exanta* and *Iressa* in 2004, the Remuneration Committee and Sir Tom McKillop agreed a reduction in his bonus. It was agreed that his bonus for 2004 should be reduced to a sum equivalent to 50% of the bonus he received in respect of 2003. This amounts to £430,000 (\$782,000). The Remuneration Committee was also mindful in setting the bonus for 2004 that all employees, including Sir Tom McKillop, who had an interest in shares throughout 2004, had seen the value of their shares fall significantly during the year, in common with other shareholders.
  - > The Chief Financial Officer was eligible for an annual bonus related to the achievement of both the targeted performance of earnings per share and the achievement of performance measures relevant to his particular area of responsibility. The bonus payable was on a scale of 0-100% of salary and 50% of salary was payable for the achievement of target business performance. 80% of the bonus related to the achievement of the earnings per share target and 20% to the other performance measures. The bonus was not pensionable.
- > Longer term incentive Executive Directors are also rewarded for improvement in the share price performance of the Company over a period of years by the grant of share options. The grant of options under the AstraZeneca Share Option Plan is determined by the Remuneration Committee, as are the performance targets that will apply and whether they will apply to the grant and/or exercise of options this is described in more detail below.
- > Pension arrangements the table on page 66 gives details of the changes in the value of the Executive Directors accrued pensions during 2004:
  - > UK Executive Directors pension arrangements the Chief Executive is a member of the Company's main UK defined benefit pension plan. The normal pension age under this plan is 62. However, a member's accrued pension is available from age 60 without any actuarial reduction. In addition the accrued pension is available, unreduced, from age 57 if the Company consents to a request for early retirement and from age 50 if the retirement is at the Company's request.

On death in retirement, the accrued pension is guaranteed payable for the first five years of retirement and then reduces to two-thirds of this amount should there be a surviving spouse or other dependant. Any member may choose higher or lower levels of survivor's pensions at retirement, subject to Inland Revenue limits, in return for an adjustment to their own pension of equivalent actuarial value. Pensions are also payable to dependant children. In the event of a senior employee becoming incapacitated, then a pension is payable immediately as if such person had reached normal retirement age (subject to a maximum of 10 years additional service), based on current pensionable salary. In the event of death prior to retirement, dependants are entitled to a pension of two-thirds of the pension that would have been earned had such person remained in service to age 62 plus a capital sum of four times pensionable pay. Pensions in payment are increased annually in line with inflation, as measured by the UK Retail Prices Index, up to a maximum of 5%.

In respect of UK Executive Directors whose pensionable earnings are capped by the earnings limit imposed by the Finance Act 1989, unapproved defined contribution schemes are made available. Currently, only the Chief Financial Officer is affected by this limit. The Company has

agreed to pay annually 50% of base salary in excess of the statutory earnings cap for the pension and associated tax liability, with the intention of providing equivalence of benefits with non-capped UK Executive Directors. If this does not provide equivalence, the Company has agreed to make up the difference. The benefits derived from equivalence are shown in the table on page 66 as if the scheme were a defined benefit arrangement. The Company contribution in 2004 in respect of the pension element was £124,000 (\$225,000).

Other customary benefits (such as a car and health benefits) are also made available through participation in the Company's flexible benefits arrangements, which extend to the vast majority of the Company's UK and Swedish employees.

#### **Measurement of performance**

Each year, as referred to above, both short term and longer term objectives are agreed with the Board and regularly monitored in respect of both individual business functions and integrated corporate strategy in the business performance report. Performance against these objectives determines functional bonuses and, separately, whether or not share options will be granted.

In respect of bonuses in 2004, relevant factors included financial results ahead of expectations and excellent progress in key areas. Earnings per share increased by 18%; global sales increased by 9% overall and by 30% in key growth products (all at constant exchange rates), with particularly strong performance in emerging markets. In Research, all targets for new compounds were exceeded; in Development, good

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Directors' Remuneration Report

## Directors Remuneration Report continued

progress was made in the restructuring of the clinical and regulatory function; in Operations, there was excellent performance in customer satisfaction, supply chain management and financial control. Bonus outcomes reflected the variety of functional performance in the context of overall business success and the disappointments in the year.

### AstraZeneca Share Option Plan

The AstraZeneca Share Option Plan was approved at the AGM in 2000 following prior consultation with major shareholders. Its design took account of the overall competitiveness of the Company's remuneration arrangements for senior executives and US employees in the context of the Company's peers in the pharmaceutical industry.

The Remuneration Committee must on every occasion, before agreeing the grant of options to Executive Directors and others, be satisfied that the most recent and also the underlying performance of the Company justifies the grant; in addition it must be satisfied that the necessary performance has been achieved by each individual.

In agreeing grants of options in 2004 (which occurred before the disappointing events relating to *Exanta* and *Iressa*), the Remuneration Committee took into account, the fact that the Company, when compared with its peer group of international pharmaceutical companies, was ranked first in terms of both relative share price and total shareholder return over the three year period January 2001 to January 2004; in 2003, the loss of \$2.6 billion in sales to generic competition was compensated for by strong growth in the sales of newer products, with the sales of those newer products representing 44% of total sales in 2003; strong sales growth (at constant exchange rates) in 2003 for *Nexium* (up 62% to \$3.3 billion), *Seroquel* (up 27% to \$1.5 billion), *Symbicort* (up 61% to \$549 million) and *Arimidex* (up 46% to

\$519 million); good progress was made with cost control initiatives and other efficiency initiatives resulting in significant savings in the area of purchasing and more effective working practices and clinical productivity in R&D. Further positive steps were taken with regard to issues in the areas of corporate responsibility, governance and access to medicines.

The Remuneration Committee also sought and received assurances that all individuals proposed for a grant of options had been confirmed as performing in a manner that justified a grant to them. It was noted that there was some variation in the level of grants being proposed between individuals, to reflect differing levels of performance.

The dilutive effect of the proposed grants of options on the Company's issued share capital was also considered by the Remuneration Committee, in accordance with the commitment, given that the percentage of the issued share capital which could be allocated under all of the Company's employee share plans over a period of ten years should be under 10%; this commitment is applied by the Remuneration Committee in practice as a limit, on average, of under 1% per annum. The Remuneration Committee concluded that a grant of options to those plan participants and individual Executive Directors proposed for a grant was appropriate given the level of performance achieved. For the grants of options in 2004 to members of the Senior Executive Team, the Remuneration Committee requested that a condition be included to the effect that if an event occurred which caused material reputational damage to the Company such that it was not appropriate for the options to vest and become exercisable, then the Remuneration Committee could make a determination to that effect.

### Review of executive remuneration

In 2000, the Company volunteered a commitment that a review of practice would

take place in five years, taking account of the view of the Company's shareholders and the needs of the business at that time. This review took place during 2004.

The Remuneration Committee reviewed its basic philosophy and confirmed that in seeking to achieve sustained growth in shareholder value it would demand the highest level of performance from all employees with the Company conducting itself in a fair and moderate way, maintaining the highest standards of social responsibility and corporate governance. In order to achieve this, it must attract and retain Executive Directors and other senior executives of the highest quality, competing for them in the global employment market and providing appropriate rewards directly linked to top performance.

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In the last five years, the Company has honoured its promise regarding shareholder dilution. Grants of options under the AstraZeneca Share Option Plan worldwide have amounted to 2.71% (plus 0.45% under the old Zeneca 1994 Executive Share Option Scheme). Dilution under other share plans has been 0.36%.

During this time, the Company has intensified its action to align reward directly with performance. For example, the business performance report has been developed as described above. This contains the short and long term strategic objectives agreed annually with the Board and cascaded down throughout the Company; these are monitored quarterly and determine both short term bonus and long term awards. In addition, the reward of employees at all levels has become increasingly differentiated based on their individual performance.

In the review, the Remuneration Committee confirmed that the reward package of Executive Directors should be primarily benchmarked against major UK based companies with global operations similar to those of AstraZeneca, as opposed to

### Details of Executive Directors service contracts at 31 December 2004

<b>Executive Director</b>	<b>Date of service contract</b>	<b>Unexpired term at 31 December 2004</b>	<b>Notice period</b>
Sir Tom McKillop	11.01.96	One year	One year
Jonathan Symonds	20.05.98	One year	One year

alignment with the global industry practice. However, in appropriately balancing the total package towards the delivery of award for demonstrable performance, bonuses and incentives should provide for upper quartile opportunity for upper quartile performance.

During 2004, the Remuneration Committee sought the views of major shareholders. As it is five years since the last major review, the Committee identified that the competitive market place in major UK companies had developed and shareholder expectations had also changed. The Remuneration Committee has taken the views of shareholders into account in formulating proposals which focus upon performance-related pay and strengthened the links to measures which are aligned to the creation of shareholder value. These proposals, primarily for the Senior Executive Team, are closely aligned to current best practice and include:

- > An increase in the annual bonus opportunity linked to a broader assessment of performance together with a requirement for the Senior Executive Team to defer a portion of their bonus earned into shares for a period of three years. As a result of the most recent consultation, the basis of determining the annual bonus for the Senior Executive Team will be changed. In the past, the whole of the bonus of the Chief Executive and 80% of those of the others was determined by reference to earnings per share. For 2005, 50% will be determined by earnings per share, 25% by measures relating to the individual's particular area of responsibility and 25% by a balance of qualitative and quantitative measures which address the quality of business performance. The Remuneration Committee would reserve the right to modify the bonus outcome if it believed it did not reflect the underlying performance of the business.
- > The introduction of performance conditions on exercise of options granted under the AstraZeneca Share Option Plan with no re-test facility, in order to bring our policy in line with best practice.
- > A requirement for executives to hold shares equivalent to one-times salary, and to retain the net number of shares acquired under the AstraZeneca Share Option Plan for at least six months after the option is exercised.
- > Subject to a shareholder vote at the AGM, the introduction of a new performance share plan based on the Company's total shareholder return relative to a global industry peer group. This test would be underpinned by the requirement of the Remuneration Committee to satisfy itself that any total shareholder return rewarded was a genuine reflection of the Company's underlying performance and it would explain its reasoning in the subsequent Directors' Remuneration Report.

The Board and the Remuneration Committee believe that bringing bonus and long term incentive opportunities closer to the market, subject to demanding performance conditions, will appropriately rebalance the proportion of reward so that variable performance-related pay is dominant and will significantly improve the Company's ability to attract and retain executives of the quality necessary to lead AstraZeneca in the future.

#### **Executive Directors' service contracts**

The service contracts of the current Executive Directors provide for a notice period of one year. For new Executive Directors, the Board would aim to negotiate a one year notice period. In exceptional circumstances, the initial notice period may be for longer than one year. In those circumstances, the Board would explain to shareholders the reasons why it believed a longer notice period was necessary and it would be the Board's intention that it should be reduced to one year subsequently. At the time of the AGM on 28 April 2005, the unexpired term of Executive Directors' service contracts will be a maximum of one year. The details of the Executive Directors' individual service contracts are set out in the table on page 62. In the event of the termination of an Executive Director's service contract, depending upon the circumstances, the Company may be liable to provide compensation to the Executive Director equivalent to the benefits which he or she would have received during

the contractual notice period. For current Executive Directors, it is the Company's expectation that any such liability would be calculated on the basis of one year's base salary, target bonus and other benefits. The Company's policy in the event of the termination of an Executive Director's service contract is to avoid any liability to the Executive Director in excess of his or her contractual entitlement and aim to ensure that any liability is mitigated to the fullest extent possible.

#### **Arrangements for Håkan Mogren and Åke Stavling**

Håkan Mogren, formerly Executive Deputy Chairman, ceased to be an Executive Director and employee of the Company and became Non-Executive Deputy Chairman at the end of August 2003. Dr Mogren's remuneration arrangements as a result of this change were considered and approved by the Remuneration Committee in 2003, based on existing contracts and practice, and were fully disclosed in the Directors' Remuneration Report for 2003. Under these arrangements, Dr Mogren received compensation from the Company which was paid on a monthly basis until the end of August 2004. The sum received by Dr Mogren in respect of

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this compensation in 2004 is included in the disclosure of Directors' emoluments on page 65.

Åke Stavling, formerly an Executive Director, left the Company at the end of January 2003. Mr Stavling's leaving arrangements were considered and approved by the Remuneration Committee in 2002, based on existing contracts and practice, and were fully disclosed in the Directors' Remuneration Report for 2003. Under these arrangements, Mr Stavling is receiving compensation from the Company which is being paid on a monthly basis until the end of January 2005. The amount of this compensation is equivalent to two years' base annual salary. Mr Stavling was entitled to a notice period of two years under his service contract at the time he left the Company. The sum received by Mr Stavling in respect of this compensation in 2004 is included in the disclosure of Directors' emoluments on page 65.

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Directors' Remuneration Report

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## Directors Remuneration Report continued

### Position of the Non-Executive Directors

None of the Non-Executive Directors has a service contract. They are not eligible for performance-related bonuses or the grant of share options. No pension contributions are made on their behalf. The fees payable to the Non-Executive Directors are set by a committee of the Board comprising the Executive Directors.

### External appointments and retention of fees

With the specific approval of the Board in each case, Executive Directors may accept external appointments as non-executive directors of other companies and retain any related fees paid to them.

Sir Tom McKillop, Chief Executive, served as a Non-Executive Director of Lloyds TSB Group plc until 31 December 2004. He was appointed as a Non-Executive Director of BP p.l.c. on 1 July 2004. In respect of each position, he retained the fees paid to him for his services. In 2004, the total amount of such fees paid to him in respect of these services was £90,000.

Jonathan Symonds, Chief Financial Officer, served as a Non-Executive Director of QinetiQ Group plc until 30 June 2004. He was appointed as a Non-Executive Director of Diageo plc on 1 May 2004. In respect of each position, he retained the fees paid to him for his services. In 2004, the total amount of such fees paid to him in respect of these services was £55,500. Mr Symonds also receives and retains fees of £15,000 per annum for his position as a member of the UK Accounting Standards Board.

### Directors' emoluments in 2004

The Directors' emoluments in 2004 are disclosed on pages 65 to 66.

### Directors' interests in shares

Details of the Directors' interests in the Company's Ordinary Shares are disclosed on pages 67 to 68.

### Audit

The Directors' emoluments in 2004 and the details of the Directors' interests in the Company's Ordinary Shares disclosed on pages 65 to 68 have been audited by the Company's external auditor.

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**Directors' emoluments in 2004**

The aggregate remuneration, excluding pension contributions, paid to or accrued for all Directors and officers of the Company for services in all capacities during the year ended 31 December 2004 was £10 million (\$17 million). Remuneration of individual Directors is set out below in sterling and US dollars. All salaries, fees and bonuses for Directors are established in sterling.

<b>Sterling</b>	Salary and fees £ 000	Bonuses £ 000	Taxable benefits £ 000	Other £ 000	<b>Total 2004 £ 000</b>	Total 2003 £ 000	Total 2002 £ 000
Percy Barnevik	250				<b>250</b>	250	250
Sir Tom McKillop	958	430	1	22 <sup>1</sup>	<b>1,411</b>	1,790	1,479
Jonathan Symonds	559	314	7	90 <sup>2</sup>	<b>970</b>	1,071	909
Sir Peter Bonfield	76				<b>76</b>	74	46
John Buchanan	61				<b>61</b>	53	334
Jane Henney	54				<b>54</b>	49	60
Michele Hooper	43				<b>43</b>	194	
Joe Jimenez	43				<b>43</b>	194	
Håkan Mogren	294			450 <sup>3</sup>	<b>479</b>	1,246	1,347
Erna Möller	54				<b>54</b>	49	62
Dame Bridget Ogilvie	54				<b>54</b>	49	62
Louis Schweitzer	314				<b>31</b>		
Marcus Wallenberg	46				<b>46</b>	46	42
<b>Former Directors</b>							
Karl von der Heyden	194				<b>19</b>	55	47
Åke Stavling				435 <sup>3</sup>	<b>435</b>	489	835
Others							621
<b>Total</b>	<b>2,277</b>	<b>744</b>	<b>8</b>	<b>997</b>	<b>4,026</b>	<b>5,259</b>	<b>5,793</b>

<sup>1</sup> Relates to relocation allowances; <sup>2</sup>Payment for pension related tax liabilities; <sup>3</sup>Compensation payment; <sup>4</sup>Part year only.

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<b>US dollars</b>	Salary and fees \$ 000	Bonuses \$ 000	Taxable benefits \$ 000	Other \$ 000	<b>Total 2004 \$ 000</b>	Total 2003 \$ 000	Total 2002 \$ 000
Percy Barnevik	455				<b>455</b>	403	373
Sir Tom McKillop	1,742	782	2	401	<b>2,566</b>	2,886	2,208
Jonathan Symonds	1,016	571	13	1642	<b>1,764</b>	1,726	1,357
Sir Peter Bonfield	138				<b>138</b>	119	68
John Buchanan	111				<b>111</b>	86	494
Jane Henney	98				<b>98</b>	79	90
Michele Hooper	78				<b>78</b>	314	
Joe Jimenez	78				<b>78</b>	314	
Håkan Mogren	534			8183	<b>871</b>	2,008	2,010
Erna Möller	98				<b>98</b>	79	93
Dame Bridget Ogilvie	98				<b>98</b>	79	93
Louis Schweitzer	564				<b>56</b>		
Marcus Wallenberg	84				<b>84</b>	74	63
<b>Former Directors</b>							
Karl von der Heyden	354				<b>35</b>	89	70
Åke Stavling				7913	<b>791</b>	788	1,246
Others							927
<b>Total</b>	<b>4,140</b>	<b>1,353</b>	<b>15</b>	<b>1,813</b>	<b>7,321</b>	<b>8,478</b>	<b>8,647</b>

1 Relates to relocation allowances; <sup>2</sup> Payment for pension related tax liabilities; <sup>3</sup> Compensation payment; <sup>4</sup> Part year only.

As described fully in the AstraZeneca Annual Report and Form 20-F Information 2003 and noted on page 63 of the Directors Remuneration Report for 2004, compensation payments to Håkan Mogren and Åke Stavling were £450,000 (\$818,000) and £435,000 (\$791,000), respectively and are included within Other in the above tables.

## Directors Remuneration Report continued

### Directors' emoluments in 2004 (continued)

The remuneration of Directors is or was in the case of former Directors (with minor exceptions) established in sterling and has been converted into US dollars in the second table on page 65 at the average exchange rate for the year in question. These rates were:

	GBP/USD
2002	0.67
2003	0.62
2004	0.55

Some Directors and officers were also granted options to subscribe for Ordinary Shares under the Company's share option plans. Details of share options granted to, and exercised by, Directors and the aggregate of gains realised on exercised options in the year are given on page 68.

No Director or officer has a family relationship with any other Director or officer.

### Pensions

Pensions are payable to Directors in sterling. For ease of understanding, the whole table has been presented in both sterling and dollars using the exchange rates for 2004 set out above.

Executive Directors Pension Arrangements (per annum)	Sir Tom McKillop £ 000	Jonathan Symonds £ 000	Sir Tom McKillop \$ 000	Jonathan Symonds \$ 000
Defined Benefit Arrangements				
1. Accrued pension at 1 January 2004	575	214	1,046	389
2. Increase in accrued pension during year as a result of inflation	18	7	33	13

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3. Adjustment to accrued pension as a result of salary increase relative to inflation	9	2	16	4
4. Increase in accrued pension as a result of additional service		11		20
5. Accrued pension at 31 December 2004	602	234	1,095	426
6. Employee contributions during year		20		36
7. Transfer value of accrued pension at 31 December 2003	10,773	1,879	19,587	3,416
8. Transfer value of accrued pension at 31 December 2004	11,585	2,190	21,064	3,982
9. Change in transfer value during the period less employee contributions	812	291	1,477	530
10. Age at 31 December 2004	61 $\frac{9}{12}$	45 $\frac{10}{12}$	61 $\frac{9}{12}$	45 $\frac{10}{12}$
11. Pensionable service (years)	35 $\frac{3}{12}$	24 $\frac{4}{12}$	35 $\frac{3}{12}$	24 $\frac{4}{12}$

**Transactions with Directors**

There were no material recorded transactions between the Company and the Directors during 2004 or 2003.

### Graph showing total shareholder return

The UK Directors' Remuneration Report Regulations 2002 require the inclusion in the Directors' Remuneration Report of a graph showing total shareholder return (TSR) over a five year period in respect of a holding of the Company's shares, plotted against TSR in respect of a hypothetical holding of shares of a similar kind and number by reference to which a broad equity market index is calculated. This illustrates the Company's TSR performance against the broad equity market index selected. The Company is a member of the FTSE 100 Index and consequently, for the purposes of this graph which is set out below, we have selected the FTSE 100 Index as the appropriate index.

### Directors' interests in shares

The interests at 31 December 2004 or on date of retirement of the persons who on that date were Directors (including the interests of their families) in shares and debentures of AstraZeneca PLC are shown below, all of which were beneficial except as otherwise stated. None of the Directors has a beneficial interest in the shares of any of the Company's subsidiaries.

	Interest in Ordinary Shares at 1 Jan 2004 or appointment date	Net shares acquired/ (disposed)	Interest in Ordinary Shares at 31 Dec 2004 or resignation date
Louis Schweitzer	4,000		4,000
Percy Barnevik	50,000		50,000
Håkan Mogren	62,164		62,164
Sir Tom McKillop	77,835		77,835
Jonathan Symonds	10,929		10,929
Sir Peter Bonfield	500		500
John Buchanan	500		500
Jane Henney	500		500
Michele Hooper	500		500
Joe Jimenez	500		500

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Erna Möller	2,718		2,718
Dame Bridget Ogilvie	500		500
Marcus Wallenberg	74,504	(3,622)	70,882
<b>Former Directors</b>			
Karl von der Heyden	20,000		20,000

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No Director or senior executive beneficially owns, or has options over, 1% or more of the outstanding shares of the Company, nor do they have different voting rights to other shareholders.

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Directors Remuneration Report

## Directors Remuneration Report continued

The interests of Directors and former Directors in options to subscribe for Ordinary Shares of the Company, which include options granted under the AstraZeneca Savings-Related Share Option Scheme, together with options granted and exercised during the year, are included in the following table:

		No. of shares under option	Exercise price per share	Market price at date of exercise	First date exercisable*	Last date exercisable*
Håkan Mogren	At 1 Jan 2004	244,896	2848p		13.12.02	24.03.13
	market price above option price	65,551	2231p		25.03.06	24.03.13
	market price below option price	179,345	3073p		13.12.02	27.03.12
	At 31 Dec 2004	244,896	2848p		13.12.02	24.03.13
	market price above option price					
	market price below option price	244,896	2848p		13.12.02	24.03.13
Sir Tom McKillop	At 1 Jan 2004	453,242	2555p		27.03.98	24.03.13
	market price above option price	256,350	2013p		27.03.98	24.03.13
	market price below option price	196,892	3260p		16.03.03	27.03.12
	Granted	118,622	2529p		26.03.07	25.03.14
	At 31 Dec 2004	571,864	2549p		27.03.98	25.03.14
	market price above option price	79,184	1311p		27.03.98	03.04.07
	market price below option price	492,680	2748p		26.03.01	25.03.14
Jonathan Symonds	At 1 Jan 2004	208,388	2691p		01.10.00	24.03.13
	market price above option price	121,444	2271p		01.10.00	24.03.13
	market price below option price	86,944	3277p		23.08.03	27.03.12
	Granted	44,049	2529p		26.03.07	25.03.14
	Granted	418	2262p		01.12.07	31.05.08
	At 31 Dec 2004	252,855	2662p		01.10.00	25.03.14
	market price above option price					
	market price below option price	252,855	2662p		01.10.00	25.03.14

Exercise prices are weighted averages.

\* First and last exercise dates of groups of options, within which periods there are shorter exercise periods.

In addition to the above, the following Directors or former Directors held options under the Astra Shareholder Value Incentive Plan which were converted into options over AstraZeneca shares on completion of the merger based on an exchange ratio of 0.5045 AstraZeneca options for each Astra option held. No further options have been or will be granted under the scheme:

### Astra SVIP Options

	No. of shares under option	Exercise price per share	Market price at date of exercise	First date exercisable*	Last date exercisable*
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Håkan Mogren	At 1 Jan 2004	16,288	429.38SEK	06.04.99	23.01.06
	market price above option price				
	market price below option price	16,288	429.38SEK	06.04.99	23.01.06
	At 31 Dec 2004	16,288	429.38SEK	06.04.99	23.01.06
	market price above option price				
	market price below option price	16,288	429.38SEK	06.04.99	23.01.06

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Exercise prices are weighted averages.

\* First and last exercise dates of groups of options, within which periods there are shorter exercise periods.

The aggregate amount of gains made by Directors on the exercise of share options during the year amounted to \$nil (2003 \$0.5 million, 2002 \$0.4 million) and the gains made by the highest paid Director were \$nil (2003 \$470,000, 2002 \$nil). The market price of shares trading on the London Stock Exchange at 31 December 2004 was 1889 pence and the range during 2004 was 1863 pence to 2749 pence. The market price of shares trading on the Stockholm Stock Exchange at 31 December 2004 was 241.50 SEK and the range during 2004 was 237.50 SEK to 374.00 SEK. The Register of Directors' Interests (which is open to inspection) contains full details of Directors' shareholdings and options to subscribe for Ordinary Shares.

**On behalf of the Board**  
**G H R Musker**  
**Group Secretary and Solicitor**  
**27 January 2005**

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## Preparation of the Financial Statements and Directors Responsibilities

The Directors are required by UK company law to prepare for each accounting period financial statements which give a true and fair view of the state of affairs of the Group and the Company as at the end of the accounting period and of the profit or loss for that period. In preparing the financial statements, the Directors are required to select suitable accounting policies and apply them consistently and make reasonable and prudent judgements and estimates. Applicable accounting standards also have to be followed and a statement made to that effect in the financial statements, subject to any material departures being disclosed and explained in the notes to the financial statements. The Directors are required to prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business. The Directors are responsible for ensuring proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for taking reasonable steps to safeguard the assets of the Group and the Company and prevent and detect fraud and other irregularities.

## Basis of Consolidation and Presentation of Financial Information

The preparation of the Financial Statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the

Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

AstraZeneca has adopted the provisions of UITF 38 Accounting for ESOP Trusts in the current year. There was no effect on results and the effect on net assets was not significant.

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## Independent Auditor's Report to the Members of AstraZeneca PLC

We have audited the Financial Statements on pages 72 to 135. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of Directors and Auditor

The Directors are responsible for preparing the Annual Report and Form 20-F Information and the Directors Remuneration Report. As described on page 70 this includes responsibility for preparing the Financial Statements in accordance with applicable UK law and accounting standards; the Directors have also presented additional information under US requirements. Our responsibilities, as independent auditor, are established in the UK by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the Financial Statements give a true and fair view and whether the Financial Statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the

We review whether the corporate governance statement on page 52 reflects the Company's compliance with the nine provisions of the 2003 FRC Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and Form 20-F Information, including the corporate governance statement and consider whether it is consistent with the audited Financial Statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Financial Statements.

### Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Statements and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable

### Opinion

In our opinion

- > the Financial Statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2004 and of the profit of the Group for the year then ended; and
- > the Financial Statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.  
27 January 2005

KPMG Audit Plc  
Chartered Accountants  
Registered Auditor  
8 Salisbury Square  
London EC4Y 8BB

*The above opinion is provided in compliance with UK requirements. An opinion in accordance with auditing standards of the Public Company Accounting Oversight Board in the US will be included in the Annual Report on Form 20-F filed with the US Securities and Exchange Commission.*

*Accounting principles generally accepted in the UK vary in certain significant respects from accounting principles generally accepted in the US. Information relating to the nature and effect of such differences is presented on pages 125 to 135.*

Companies Act 1985. We also report to you if, in our opinion, the Directors Report is not consistent with the Financial Statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors remuneration and transactions with the Group is not disclosed.

assurance that the Financial Statements and the part of the Directors Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Financial Statements and the part of the Directors Remuneration Report to be audited.

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AstraZeneca Annual Report and  
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Financial Statements

## Group Profit and Loss Account for the year ended 31 December

	Notes	Before exceptional items \$m	Exceptional items \$m	2004 Total \$m
Group turnover		21,426		21,426
Operating costs	1	(16,971)		(16,971)
Other operating income	1	315		315
<b>Group operating profit</b>	1	4,770		4,770
Share of operating profits of joint venture	2			
Profit on sale of interest in joint venture	3		219	219
Dividend income		6		6
<b>Profit on ordinary activities before interest</b>		4,776	219	4,995
Net interest	4	90		90
<b>Profit on ordinary activities before taxation</b>		4,866	219	5,085
Taxation	5	(1,321)	67	(1,254)
<b>Profit on ordinary activities after taxation</b>		3,545	286	3,831
Attributable to minorities		(18)		(18)
<b>Net profit for the financial year</b>		3,527	286	3,813
Dividends to shareholders	6			(1,555)
<b>Profit retained for the financial year</b>				2,258
Earnings per \$0.25 Ordinary Share before exceptional items	7	\$2.11		\$2.11
Earnings per \$0.25 Ordinary Share (basic)	7	\$2.11	\$0.17	\$2.28
Earnings per \$0.25 Ordinary Share (diluted)	7	\$2.11	\$0.17	\$2.28
Weighted average number of Ordinary Shares in issue (millions)	7			1,673

All activities were in respect of continuing operations. There were no material differences between reported profits and losses and historical cost profits and losses on ordinary activities before taxation.

## Group Statement of Total Recognised Gains and Losses for the year ended 31 December

	Notes	2004 \$m
<b>Net profit for the financial year</b>		<b>3,813</b>
Foreign exchange adjustments on consolidation	20	713
Tax on foreign exchange adjustments on consolidation	20	379
Translation differences on foreign currency borrowings	20	
Tax on translation differences on foreign currency borrowings	20	
<b>Total recognised gains and losses relating to the financial year</b>		<b>4,905</b>

Tax on foreign exchange adjustments on consolidation in 2004 includes a credit of \$357m in respect of foreign exchange losses arising in 2000 (see Note 5).

\$m means millions of US dollars



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Before exceptional items \$m	Exceptional items \$m	2003 Total \$m	Before exceptional items \$m	Exceptional items \$m	2002 Total \$m
18,849		18,849	17,841		17,841
(14,938)		(14,938)	(13,728)	(350)	(14,078)
200		200	243		243
4,111		4,111	4,356	(350)	4,006
2		2	1		1
4,113		4,113	4,357	(350)	4,007
89		89	30		30
4,202		4,202	4,387	(350)	4,037
(1,143)		(1,143)	(1,177)		(1,177)
3,059		3,059	3,210	(350)	2,860
(23)		(23)	(24)		(24)
3,036		3,036	3,186	(350)	2,836
		(1,350)			(1,206)
		1,686			1,630
\$1.78		\$1.78	\$1.84		\$1.84
\$1.78		\$1.78	\$1.84	(\$0.20)	\$1.64
\$1.78		\$1.78	\$1.84	(\$0.20)	\$1.64
		1,709			1,733

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	2003 \$m	2002 \$m
	3,036	2,836
	1,361	971
	66	135
		6
		(2)
	4,463	3,946

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## Group Balance Sheet at 31 December

	Notes	2004 \$m	2003 \$m
<b>Fixed assets</b>			
Tangible fixed assets	9	8,083	7,536
Goodwill and intangible assets	10	2,826	2,884
Fixed asset investments	11	267	220
		<b>11,176</b>	10,640
<b>Current assets</b>			
Stocks	12	3,020	3,022
Debtors	13	6,274	5,960
Short term investments	14	4,091	3,218
Cash		1,055	733
		<b>14,440</b>	12,933
<b>Total assets</b>		<b>25,616</b>	23,573
<b>Creditors due within one year</b>			
Short term borrowings and overdrafts	15	(142)	(152)
Other creditors	16	(7,640)	(7,543)
		<b>(7,782)</b>	(7,695)
<b>Net current assets</b>		<b>6,658</b>	5,238
<b>Total assets less current liabilities</b>		<b>17,834</b>	15,878
<b>Creditors due after more than one year</b>			
Loans	17	(1,030)	(303)
Other creditors	16	(78)	(52)
		<b>(1,108)</b>	(355)
<b>Provisions for liabilities and charges</b>	19	<b>(2,207)</b>	(2,266)

<b>Net assets</b>		<b>14,519</b>	13,257
<hr/>			
<b>Capital and reserves</b>			
Called-up share capital	34	<b>411</b>	423
<hr/>			
Share premium account	21	<b>550</b>	449
<hr/>			
Capital redemption reserve	21	<b>36</b>	23
<hr/>			
Merger reserve	21	<b>433</b>	433
<hr/>			
Other reserves	21	<b>1,382</b>	1,401
<hr/>			
Profit and loss account	21	<b>11,606</b>	10,449
<hr/>			
<b>Shareholders funds equity interests</b>	20	<b>14,418</b>	13,178
<hr/>			
<b>Minority equity interests</b>		<b>101</b>	79
<hr/>			
<b>Shareholders funds and minority interests</b>		<b>14,519</b>	13,257
<hr/>			

The Financial Statements on pages 72 to 135 were approved by the Board of Directors on 27 January 2005 and were signed on its behalf by:

Sir Tom McKillop    Jonathan Symonds  
**Director**            **Director**

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## Statement of Group Cash Flow for the year ended 31 December

	Notes	2004 \$m	2003 \$m	2002 \$m
<b>Cash flow from operating activities</b>				
Net cash inflow from trading operations	22	6,069	4,617	5,686
Cash outflow related to exceptional items	23	(8)	(391)	(93)
<b>Net cash inflow from operating activities</b>		<b>6,061</b>	<b>4,226</b>	<b>5,593</b>
<b>Returns on investments and servicing of finance</b>				
Interest received		119	117	142
Interest paid		(62)	(32)	(96)
Dividends received		6	2	
Dividends paid by subsidiaries to minority interests		(5)	(11)	(11)
		58	76	35
<b>Tax paid</b>		<b>(1,246)</b>	<b>(886)</b>	<b>(795)</b>
<b>Capital expenditure and financial investment</b>				
Cash expenditure on tangible fixed assets	9	(1,063)	(1,282)	(1,340)
Cash expenditure on intangible assets		(151)	(233)	(268)
Cash expenditure on fixed asset investments		(117)	(120)	(1)
Disposals of fixed assets		35	38	66
		(1,296)	(1,597)	(1,543)
<b>Acquisitions and disposals</b>				
Disposals of business operations	24	355	80	
<b>Equity dividends paid to shareholders</b>		<b>(1,378)</b>	<b>(1,222)</b>	<b>(1,234)</b>
<b>Net cash inflow before management of liquid resources and financing</b>	26	<b>2,554</b>	<b>677</b>	<b>2,056</b>
<b>Management of liquid resources and financing</b>				
Movement in short term investments and fixed deposits (net)	26	(862)	771	(806)
Financing	27	727	(345)	(118)

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Net share re-purchases	27	(2,110)	(1,107)	(1,154)
<b>Increase/(decrease) in cash in the year</b>	25	<b>309</b>	(4)	(22)
Cash (inflow)/outflow from (increase)/decrease in loans and short term borrowings		(727)	345	118
Cash outflow/(inflow) from increase/(decrease) in short term investments		862	(771)	806
Change in net funds resulting from cash flows		444	(430)	902
Exchange movements		34	82	75
<b>Movement in net funds</b>		<b>478</b>	(348)	977

## Accounting Policies

### Basis of accounting

The Financial Statements are prepared under the historical cost convention, modified to include the revaluation to market value of certain current asset investments held by Group subsidiaries as described below, in accordance with the Companies Act 1985 and UK generally accepted accounting principles (UK GAAP). Where there are significant differences to US GAAP these have been described in the US GAAP section on pages 125 to 135. The following paragraphs describe the main accounting policies under UK GAAP, which have been applied consistently. The accounting policies of some overseas subsidiaries and associated undertakings do not conform with UK GAAP and, where appropriate, adjustments are made on consolidation in order to present the Group Financial Statements on a consistent basis.

AstraZeneca's management considers the following to be the most important accounting policies in the context of the Group's operations.

#### *Turnover*

Turnover excludes intercompany turnover and value added taxes and represents net invoice value less estimated rebates, returns and settlement discounts. Revenue is recognised at the point at which title passes.

#### *Research and development*

Internally generated research and development expenditure is charged to profit in the year in which it is incurred.

#### *Goodwill and intangible assets*

On the acquisition of a business, fair values are attributed to the net assets acquired. Goodwill arises

calculated after charging the gross amount, at current exchange rates, of any such goodwill.

Intangible assets, including patents acquired, are capitalised and amortised over their estimated useful lives (generally not exceeding 20 years), in line with the benefits accruing. If related products fail, the remaining unamortised amounts are immediately written off to revenue expense. Finance costs and internally developed intangible assets are not capitalised. All intangible assets are reviewed for impairment when there are indications that the carrying value may not be recoverable.

#### *Post-retirement benefits*

The pension costs relating to UK retirement plans are assessed in accordance with the advice of independent qualified actuaries. The amounts so determined include the regular cost of providing the benefits under the plans, which it is intended should remain as a level percentage of current and expected future earnings of the employees covered under the plans. Variations from the regular pension cost are spread on a systematic basis over the estimated average remaining service lives of current employees in the plans. Retirement plans of non-UK subsidiaries are accounted for in accordance with local conditions and practice. With minor exceptions, these subsidiaries recognise the expected cost of providing pensions on a systematic basis over the average remaining service lives of employees in accordance with the advice of independent qualified actuaries. The costs of providing post-retirement benefits other than pensions (principally healthcare) are charged to the profit and loss account on a consistent basis over the average service lives of employees. Such

currency loans, are taken to operating profit. In the consolidated Financial Statements, exchange differences arising on consolidation of the net investments in subsidiaries, joint ventures and associates, together with those on relevant foreign currency loans, are taken directly to reserves via the statement of total recognised gains and losses.

#### *Taxation*

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and for accounting purposes. Full provision is made for the effects of these differences. Deferred tax asset valuation allowances are made where it is more likely than not that the asset will not be realised in the future. These valuations require judgements to be made including the forecast of future taxable income. Deferred tax balances are not discounted.

Accruals for tax contingencies require management to make judgements and estimates in relation to tax audit issues and exposures. Tax benefits are not recognised unless the tax positions will probably be sustained. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of that benefit on the basis of potential settlement through negotiation and/or litigation.

Any recorded exposure to interest on tax liabilities is provided for in the tax charge. All provisions are included in creditors due within one year.

where the fair value of the consideration given for a business exceeds the fair value of such net assets. Goodwill arising on acquisitions since 1998 is capitalised and amortised over its estimated useful life (generally not exceeding 20 years). Goodwill is reviewed for impairment when there are indications that the carrying value may not be recoverable. The Group's policy up to and including 1997 was to eliminate goodwill arising upon acquisitions against reserves. Such goodwill will remain eliminated against reserves until disposal or termination of the previously acquired business (including the planned disposal or termination when there are indications that the value of the goodwill has been permanently impaired), when the profit or loss on disposal or termination will be

costs are assessed in accordance with the advice of independent qualified actuaries. AstraZeneca has adopted the disclosure requirements of FRS 17.

*Foreign currencies*

Profit and loss accounts in foreign currencies are translated into US dollars at average rates for the relevant accounting periods. Assets and liabilities are translated at exchange rates prevailing at the date of the Group balance sheet.

Exchange gains and losses on short term foreign currency borrowings and deposits are included within net interest payable. Exchange differences on all other transactions, except relevant foreign

No provision is made for unremitted earnings of foreign subsidiaries where there is no commitment to remit such earnings and where there is a plan to permanently reinvest such earnings. No provision is made for rolled over capital gains.

*Tangible fixed assets*

AstraZeneca's policy is to write off the difference between the cost of each tangible fixed asset in use and its residual value evenly over its estimated remaining life. Assets under construction are not depreciated. Reviews are made periodically of the estimated remaining lives of individual productive assets, taking account of commercial and technological obsolescence as well as normal wear and tear. Under this policy it becomes impracticable to calculate



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average asset lives exactly. However, the total lives range from approximately 13 to 50 years for buildings, and three to 15 years for plant and equipment. All tangible fixed assets are reviewed for impairment when there are indications that the carrying value may not be recoverable.

*Leases*

Assets held under finance leases are capitalised and included in tangible fixed assets at fair value. Each asset is depreciated over the shorter of the lease term or its useful life. The obligations related to finance leases, net of finance charges in respect of future periods, are included, as appropriate, under creditors due within, or creditors due after, one year. The interest element of the rental obligation is allocated to accounting periods during the lease term to reflect a constant rate of interest on the remaining balance of the obligation for each accounting period. Rentals under operating leases are charged to the profit and loss account as incurred.

*Investments*

An associate is an undertaking, not being a subsidiary or joint venture, in which AstraZeneca has a participating interest and over whose commercial and financial policy decisions AstraZeneca exercises significant influence.

A joint venture is an entity in which AstraZeneca holds an interest on a long term basis and which is jointly controlled by AstraZeneca and one or more other venturers under a contractual arrangement.

AstraZeneca's share of the profits less losses of all significant joint ventures and associates is included in the Group profit and loss account on the equity accounting basis or, in the case of joint ventures, the gross equity accounting basis. The holding value of significant associates and joint ventures in the Group balance sheet is

Current asset investments held by the Group's insurance company subsidiaries, to the extent that they are actively matched against insurance liabilities, are valued at market value and unrealised gains and losses are taken directly to reserves via the statement of total recognised gains and losses. Realised gains and losses are taken to the profit and loss account.

*Contingent liabilities*

Through the normal course of business, AstraZeneca is involved in legal disputes, the settlement of which may involve cost to the Group. Provision is made where an adverse outcome is probable and associated costs can be estimated reliably.

AstraZeneca is exposed to environmental liabilities relating to its past operations, principally in respect of soil and groundwater remediation costs. Provisions for these costs are made when there is a present obligation, it is probable that expenditure on remedial work will be required and a reliable estimate can be made of the cost.

*Stock valuation*

Stocks are stated at the lower of cost or net realisable value. The first in, first out or an average method of valuation is used. In determining cost, depreciation is included but selling expenses and certain overhead expenses (principally central administration costs) are excluded. Net realisable value is determined as estimated selling price less costs of disposal.

*Principal financial instruments*

Forward foreign exchange contracts for existing transactions are revalued to year end spot rates and the gains/losses arising are recognised in the Group profit and loss account. Interest differentials are amortised on a straight line basis over the life of the contract.

calculated by reference to AstraZeneca's equity in the net assets of such associates and joint ventures, as shown by the most recent accounts available, adjusted where appropriate and including goodwill on acquisitions made since 1 January 1998.

Fixed asset investments are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

The gains/losses on forward foreign exchange contracts and currency option contracts hedging anticipated exposures are deferred until the date the underlying transaction being hedged is completed.

Interest rate swaps are accounted for on an accruals basis. Cross-currency swaps are translated at year end exchange rates; gains/losses arising are included in the measurement of the related liabilities and dealt with in the Group profit and loss account or reserves as appropriate.

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## Notes to the Financial Statements

### 1 Group operating profit

	Before exceptional items \$m	Exceptional items \$m	<b>2004 Total \$m</b>
<b>Group turnover</b>	21,426		<b>21,426</b>
<b>Operating costs</b>			
Cost of sales	(5,150)		<b>(5,150)</b>
Distribution costs	(177)		<b>(177)</b>
Research and development	(3,803)		<b>(3,803)</b>
Selling, general and administrative expenses	(7,841)		<b>(7,841)</b>
	(16,971)		<b>(16,971)</b>
<b>Other operating income</b>			
Royalties	95		<b>95</b>
Other income	220		<b>220</b>
	315		<b>315</b>
<b>Group operating profit</b>	4,770		<b>4,770</b>
Charges included above			
for depreciation	(916)		<b>(916)</b>
for amortisation	(311)		<b>(311)</b>
for impairment	(41)		<b>(41)</b>
Gross profit, as defined by the Companies Act 1985	16,276		<b>16,276</b>

Cost of sales includes charges against stock and prepayments in respect of *Exanta* and *Iressa* totalling \$195m. Other income includes gains arising from disposals under ongoing product and investment rationalisation programmes.

The charge for impairment arises from writing off fixed assets and goodwill associated with *Iressa* and *Exanta*.

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Before exceptional items \$m	Exceptional items \$m	2003 Total \$m	Before exceptional items \$m	Exceptional items \$m	2002 Total \$m
18,849		18,849	17,841		17,841
(4,469)		(4,469)	(4,520)		(4,520)
(162)		(162)	(141)		(141)
(3,451)		(3,451)	(3,069)		(3,069)
(6,856)		(6,856)	(5,998)	(350)	(6,348)
(14,938)		(14,938)	(13,728)	(350)	(14,078)
90		90	113		113
110		110	130		130
200		200	243		243
4,111		4,111	4,356	(350)	4,006
(986)		(986)	(705)		(705)
(304)		(304)	(255)		(255)
14,380		14,380	13,321		13,321

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## Notes to the Financial Statements continued

### 2 Share of turnover and operating profits of joint venture

	2004 \$m	2003 \$m	2002 \$m
Share of joint venture turnover	227	208	191

There was no share of operating profits of the joint venture attributable to the Group.

On 1 September 2004, the Group disposed of its interest in the ordinary share capital of Advanta BV, its only major joint venture. The profit on disposal is shown in Note 3.

### 3 Exceptional items

	2004 \$m	2003 \$m	2002 \$m
Accrual related to <i>Zoladex</i> investigation			(350)
<b>Exceptional items included in operating profit</b>			<b>(350)</b>
Profit on sale of interest in joint venture	219		
<b>Total exceptional items before taxation</b>	<b>219</b>		<b>(350)</b>
Net taxation credit	67		
<b>Total exceptional items after taxation</b>	<b>286</b>		<b>(350)</b>

The profit on sale of interest in joint venture relates to the disposal of the Group's interest in the ordinary share capital of Advanta BV. There is a tax credit of \$9m arising on costs associated with the disposal.

As set out in more detail in Note 5, the Company announced on 20 June 2003 a settlement of the US Department of Justice investigation into the US sales and marketing practices for *Zoladex* (goserelin acetate implant). Negotiations towards this settlement were sufficiently advanced to recognise an exceptional charge of \$350m at 31 December 2002. An agreement has been reached with the US tax authorities that \$170m of the settlement is deductible for tax purposes. Consequently an exceptional tax credit of \$58m has been recorded in 2004.

These items are regarded as exceptional due to their unusual and non-recurring nature. There were no exceptional items in 2003.

**4 Net interest**

	2004 \$m	2003 \$m	2002 \$m
<b>Interest receivable and similar income from investments</b>			
Securities	10	21	21
Short term deposits	81	75	90
Gain on disposal of interest rate swap	30		
Exchange gains	15	19	6
	<b>136</b>	115	117
<b>Interest payable and similar charges</b>			
Loan interest	(30)	(7)	(10)
Interest on short term borrowings and other financing costs	(16)	(16)	(51)
Discount on liability		(3)	(10)
Exchange losses			(16)
	<b>(46)</b>	(26)	(87)
<b>Net interest receivable</b>	<b>90</b>	89	30

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**5 Taxation**

Profit on ordinary activities before taxation, as shown in the Group profit and loss account, was as follows:

	<b>2004</b>	2003	2002
	<b>\$m</b>	\$m	\$m
UK	<b>1,123</b>	879	741
Overseas	<b>3,962</b>	3,323	3,296
	<b>5,085</b>	4,202	4,037

Taxes on profit on ordinary activities were as follows:

## UK taxation

Corporation tax	<b>379</b>	142	165
Double taxation relief	<b>(22)</b>	(23)	(29)
Adjustments in respect of prior periods	<b>(178)</b>		
Deferred taxation	<b>45</b>	102	24
	<b>224</b>	221	160

## Overseas taxation

Overseas taxes	<b>992</b>	783	929
Adjustments in respect of prior periods	<b>7</b>	26	(51)
Deferred taxation	<b>31</b>	113	139
	<b>1,030</b>	922	1,017
<b>Tax on profit on ordinary activities</b>	<b>1,254</b>	1,143	1,177

UK and overseas taxation has been provided at current rates on the profits earned for the periods covered by the Group Financial Statements. The prior period adjustment in respect of UK taxation relates to the settlement of a number of tax issues covering several accounting periods including merger costs, divestment provisions and fixed asset



valuations. Deferred tax profit and loss account amounts arise principally in respect of the origination and reversal of timing differences. To the extent that dividends remitted from overseas subsidiaries, joint ventures and associates are expected to result in additional taxes, appropriate amounts have been provided for. No deferred tax has been provided for unremitted earnings of Group companies overseas as these are, in the main, considered permanently employed in the businesses of these companies and, in the case of joint ventures and associates, the taxes would not be material. Cumulative unremitted earnings of overseas subsidiaries and related undertakings totalled approximately \$11,073m at 31 December 2004 (2003 \$9,381m). Unremitted earnings may be liable to overseas taxes and/or UK taxation (after allowing for double taxation relief) if they were to be distributed as dividends.

Exceptional items included in tax on profit on ordinary activities:

	2004 \$m	2003 \$m	2002 \$m
Tax credit on exceptional items*	(67)		

\* Includes deferred tax relief of \$9m (2003 \$nil, 2002 \$nil).

The tax credit on exceptional items includes an amount of \$58m arising from an agreement with the US tax authority to allow \$170m of the *Zoladex* settlement (originally accrued in 2002 and paid in 2003) as deductible for tax. There is also a tax credit of \$9m arising on costs associated with the disposal of Advanta BV.

#### Statement of total recognised gains and losses

In certain circumstances, tax charges or credits on currency translation differences on foreign currency borrowings are taken to reserves via the statement of total recognised gains and losses. The tax charge on such currency translation differences amounted to \$nil in 2004 (2003 \$nil, 2002 \$2m) and has been reported in the statement of total recognised gains and losses. The tax credit on other consolidation exchange adjustments taken to reserves amounted to \$22m in 2004 (2003 \$66m, 2002 \$135m).

The movement in reserves via the statement of total recognised gains and losses also includes a tax credit of \$357m, arising from agreement with the tax authorities to allow a proportion of certain foreign exchange losses arising on intra-group balances in 2000.

#### Factors affecting future tax charges

As a group involved in worldwide operations, AstraZeneca is subject to several factors that may affect future tax charges, principally the levels and mix of profitability in different jurisdictions, transfer pricing policies and tax levels imposed. A number of material items currently under audit and negotiation are set out in detail in Note 30.

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## Notes to the Financial Statements

### continued

#### 5 Taxation (continued)

##### Tax reconciliation to UK statutory rate

The table shown below reconciles the UK statutory tax charge to the Group's current tax charge on profit on ordinary activities before taxation.

	2004 \$m	2003 \$m	2002 \$m
Profit on ordinary activities before taxation	5,085	4,202	4,037
Notional taxation charge at UK corporation tax rate of 30% (30% for 2003, 30% for 2002)	1,525	1,261	1,211
Differences in effective overseas tax rates	55	159	141
Capital allowances/tax reliefs in excess of depreciation	(33)	(291)	(291)
Untaxed reserves	(186)	(51)	(75)
Other timing differences	145	(168)	35
Items not deductible for tax purposes	38	80	49
Items not chargeable for tax purposes	(71)	(88)	(110)
Adjustments in respect of prior periods	(171)	26	(51)
Exceptional items	(124)		105
Current tax charge for the year	1,178	928	1,014

##### Balance sheet

	2004 \$m	2003 \$m	2002 \$m
<b>Deferred taxation (liability)/asset movement</b>			
At beginning of year	(693)	(359)	(212)
Profit and loss account	(76)	(215)	(163)
Statement of total recognised gains and losses	78		155

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Disposal of subsidiary undertakings	<b>4</b>	13	
Exchange	<b>(112)</b>	(132)	(139)
At end of year	<b>(799)</b>	(693)	(359)
Debtors amount due within one year (Note 13)	<b>623</b>	732	625
Debtors amount due after more than one year (Note 13)	<b>159</b>	165	226
Provisions (Note 19)	<b>(1,581)</b>	(1,590)	(1,210)
	<b>(799)</b>	(693)	(359)

[Back to Contents](#)**5 Taxation (continued)****Deferred taxation**

The amounts of deferred taxation accounted for in the Group balance sheet, before netting off of balances within countries, comprised the following deferred tax liabilities and assets:

	2004 \$m	2003 \$m
<b>Deferred tax liabilities</b>		
UK fixed assets	609	501
Non-UK fixed assets	767	735
Interest accruals	28	18
Untaxed reserves	360	137
Pension and post-retirement benefits	194	86
Other	89	175
	<b>2,047</b>	1,652
<b>Deferred tax assets</b>		
Intercompany inventory transfers	643	527
Non-UK fixed assets	44	28
Accrued expenses	384	238
Pension and post-retirement benefits	94	55
Other	83	111
	<b>1,248</b>	959
Deferred tax liability (net)	<b>(799)</b>	(693)

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No provision has been made, in accordance with FRS 19, for rolled over gains amounting to \$106m (2003 \$131m, 2002 \$118m).

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## Notes to the Financial Statements continued

## 6 Dividends to shareholders

	2004 Per share	2003 Per share	2002 Per share	2004 \$m	2003 \$m	2002 \$m
Interim, paid on 20 September 2004	\$0.295	\$0.255	\$0.230	494	436	398
Second interim, to be confirmed as final, payable 21 March 2005	\$0.645	\$0.540	\$0.470	1,061	914	808
	\$0.940	\$0.795	\$0.700	1,555	1,350	1,206

## 7 Earnings per \$0.25 Ordinary Share

	2004	2003	2002
Net profit for the financial year before exceptional items (\$m)	3,527	3,036	3,186
Exceptional items after tax (\$m) (see Note 3)	286		(350)
Net profit for the financial year (\$m)	3,813	3,036	2,836
Earnings per Ordinary Share before exceptional items	\$2.11	\$1.78	\$1.84
Earnings/(loss) per Ordinary Share on exceptional items	\$0.17		(\$0.20)
Earnings per Ordinary Share	\$2.28	\$1.78	\$1.64
Diluted earnings per Ordinary Share before exceptional items	\$2.11	\$1.78	\$1.84
Diluted earnings/(loss) per Ordinary Share on exceptional items	\$0.17		(\$0.20)
Diluted earnings per Ordinary Share	\$2.28	\$1.78	\$1.64
Weighted average number of Ordinary Shares in issue for basic earnings (millions)	1,673	1,709	1,733

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Dilutive impact of share options outstanding (millions)	2	3	2
<hr/>			
Diluted average number of Ordinary Shares in issue (millions)	1,675	1,712	1,735
<hr/>			

There are no options, warrants or rights outstanding in respect of unissued shares except for employee share option schemes. The number of options outstanding and the weighted average exercise price of these options is shown in Note 29. The earnings figures used in the calculations above are unchanged for diluted earnings per Ordinary Share. Earnings per Ordinary Share before exceptional items have been calculated to eliminate the impact of exceptional items on the results of the business.

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[Back to Contents](#)**8 Segment information**

The Group's activities are in one class of business, pharmaceuticals. There are no other significant classes of business, either singularly or in aggregate.

**Geographic areas**

The tables below show information by geographic area and, for turnover and tangible fixed assets, material countries. The figures show the turnover, operating profit and profit on ordinary activities before interest and taxation made by companies located in that area/country, together with net operating assets and tangible fixed assets owned by the same companies; export sales and the related profit are included in the area/country from which those sales were made.

	Turnover		
	2004 \$m	2003 \$m	2002 \$m
<b>UK</b>			
External	1,108	928	872
Intra-Group	4,927	3,060	3,092
	<b>6,035</b>	<b>3,988</b>	<b>3,964</b>
<b>Continental Europe</b>			
Belgium	325	260	225
France	1,569	1,420	1,111
Germany	961	852	682
Italy	922	824	676
The Netherlands	205	174	226
Spain	709	606	461
Sweden	723	685	619



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Others	1,419	1,227	1,028
Intra-Group	3,545	2,606	1,646
	10,378	8,654	6,674
<b>The Americas</b>			
Canada	876	712	570
US	9,604	8,720	9,325
North America	10,480	9,432	9,895
Others	420	339	334
Intra-Group	484	375	235
	11,384	10,146	10,464
<b>Asia, Africa &amp; Australasia</b>			
Australia	451	364	273
Japan	1,364	1,136	960
Others	770	602	479
Intra-Group	39	35	30
	2,624	2,137	1,742
Continuing operations	30,421	24,925	22,844
Intra-Group eliminations	(8,995)	(6,076)	(5,003)
	21,426	18,849	17,841

Export sales from the UK totalled \$5,489m for the year ended 31 December 2004 (2003 \$3,490m, 2002 \$3,368m). In the US, sales to three wholesalers accounted for approximately 80% of our US sales.

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## 8 Segment information (continued)

Profit from	Operating profit after exceptional items			Profit on ordinary activities before interest and taxation		
	2004 \$m	2003 \$m	2002 \$m	2004 \$m	2003 \$m	2002 \$m
UK	1,074	810	672	1,076	812	673
Continental Europe	2,229	2,241	1,689	2,452	2,241	1,689
The Americas	1,192	816	1,473	1,192	816	1,473
Asia, Africa & Australasia	275	244	172	275	244	172
Continuing operations	4,770	4,111	4,006	4,995	4,113	4,007

	Net operating assets*		
	2004 \$m	2003 \$m	2002 \$m
UK	4,429	4,146	3,101
Continental Europe	5,483	5,771	4,805
The Americas	2,336	1,931	1,004
Asia, Africa & Australasia	1,194	1,033	958
Continuing operations	13,442	12,881	9,868

\* Net operating assets exclude short term investments, cash, short term borrowings, loans and non-operating debtors and creditors.

	Tangible fixed assets		
	2004 \$m	2003 \$m	2002 \$m
UK	2,655	2,502	2,319
Sweden	2,359	2,122	1,626

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US	<b>1,153</b>	1,095	1,031
Others	<b>1,916</b>	1,817	1,621
Continuing operations	<b>8,083</b>	7,536	6,597

**Geographic markets**

The table below shows turnover in each geographic market in which customers are located.

	<b>2004 \$m</b>	2003 \$m	2002 \$m
UK	<b>590</b>	532	623
Continental Europe	<b>7,060</b>	6,177	5,072
The Americas	<b>10,971</b>	9,835	10,287
Asia, Africa & Australasia	<b>2,805</b>	2,305	1,859
Continuing operations	<b>21,426</b>	18,849	17,841

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**9 Tangible fixed assets**

	Land and buildings \$m	Plant and equipment \$m	Assets in course of construction \$m	Total tangible assets \$m
<b>Cost</b>				
At beginning of year	4,128	7,964	948	13,040
Capital expenditure	17	195	851	1,063
Transfer of assets into use	430	641	(1,071)	
Disposals and other movements	(55)	(329)	(6)	(390)
Exchange adjustments	281	589	45	915
At end of year	4,801	9,060	767	14,628
<b>Depreciation</b>				
At beginning of year	1,139	4,365		5,504
Charge for year	172	744		916
Impairment		31		31
Disposals and other movements	(37)	(299)		(336)
Exchange adjustments	86	344		430
At end of year	1,360	5,185		6,545
<b>Net book value at 31 December 2004</b>	<b>3,441</b>	<b>3,875</b>	<b>767</b>	<b>8,083</b>
Net book value at 31 December 2003	2,989	3,599	948	7,536

The impairment charge in the year was made to write off assets associated with *Iressa*.

Capital expenditure in the year of \$1,063m (2003 \$1,239m) did not include any capitalised finance leases (2003 \$nil). Cash expenditure on tangible fixed assets was \$1,063m (2003 \$1,282m, 2002 \$1,340m).

<b>2004</b>	2003
<b>\$m</b>	\$m

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The net book value of land and buildings comprised		
Freeholds	<b>3,434</b>	2,988
<hr/>		
Short leases	<b>7</b>	1
<hr/>		
	<b>3,441</b>	2,989
<hr/>		
<hr/>		

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## Notes to the Financial Statements continued

### 10 Goodwill and intangible assets

	Goodwill \$m	Intangible assets \$m	Total \$m
<b>Cost</b>			
At beginning of year	1,155	3,622	4,777
Additions		151	151
Exchange and other movements	18	204	222
At end of year	1,173	3,977	5,150
<b>Amortisation</b>			
At beginning of year	322	1,571	1,893
Charge for year	49	262	311
Impairment	10		10
Exchange and other movements	2	108	110
At end of year	383	1,941	2,324
<b>Net book value at 31 December 2004</b>	<b>790</b>	<b>2,036</b>	<b>2,826</b>
Net book value at 31 December 2003	833	2,051	2,884

The impairment is in relation to the write-off of goodwill associated with *Exanta*.

### 11 Fixed asset investments

	Joint venture \$m	Other investments \$m	Total \$m
<b>Cost</b>			
At beginning of year	134	220	354
Additions		117	117
Disposals and other movements, including exchange	(134)	(63)	(197)

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At end of year	274	274
<b>Provisions</b>		
At beginning of year		
Additions	(5)	(5)
Disposals and other movements, including exchange	(2)	(2)
At end of year	(7)	(7)
<b>Share of post-acquisition reserves</b>		
At beginning of year	(134)	(134)
Disposals and other movements, including exchange	134	134
At end of year		
<b>Net book value at 31 December 2004</b>	<b>267</b>	<b>267</b>
Net book value at 31 December 2003	220	220

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**11 Fixed asset investments (continued)****Share of joint venture assets and liabilities**

	2004 \$m	2003 \$m
Gross assets		174
Gross liabilities		(174)

The group disposed of its joint venture Advanta BV on 1 September 2004. The profit on disposal is disclosed in Note 3.

**12 Stocks**

	2004 \$m	2003 \$m
Raw materials and consumables	646	715
Stocks in process	970	1,206
Finished goods and goods for resale	1,404	1,101
	<b>3,020</b>	3,022

**13 Debtors**

	2004 \$m	2003 \$m
<b>Amounts due within one year</b>		
Trade debtors	3,636	3,260
Less: Amounts provided for doubtful debts	(46)	(57)
	<b>3,590</b>	3,203
Deferred taxation (Note 5)	623	732



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Other debtors	492	508
Prepayments and accrued income*	1,110	1,093
	5,815	5,536
<b>Amounts due after more than one year</b>		
Deferred taxation (Note 5)	159	165
Other debtors	78	32
Prepayments and accrued income*	222	227
	459	424
	6,274	5,960

\* Figures include prepaid pension costs (Note 28).

**Provisions for doubtful debts**

	2004 \$m	2003 \$m	2002 \$m
Balance at beginning of year	57	56	42
Profit and loss account charge		8	11
Amounts utilised and other movements	(11)	(7)	3
Balance at end of year	46	57	56

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## Notes to the Financial Statements continued

### 14 Short term investments

	2004 \$m	2003 \$m
Listed debt securities		3
Other listed investments	14	54
Investment securities	14	57
Fixed deposits	4,077	3,161
	<b>4,091</b>	<b>3,218</b>

The Group's insurance subsidiaries hold cash and short term investments totalling \$326m (2003 \$298m), of which \$207m (2003 \$195m) is required to meet insurance solvency requirements and which, as a result, is not readily available for the general purposes of the Group.

### 15 Short term borrowings and overdrafts

	2004 \$m	2003 \$m
<b>Bank borrowings</b>		
Fixed securities	12	7
Unsecured	130	145
	<b>142</b>	<b>152</b>

### 16 Other creditors

2004 \$m	2003 \$m
-------------	-------------

<b>Amounts due within one year</b>		
Trade creditors	<b>3,125</b>	3,086
Corporate taxation	<b>967</b>	1,353
Value added and payroll taxes and social security	<b>282</b>	255
Other creditors	<b>1,008</b>	946
Accruals	<b>1,197</b>	989
Dividends to shareholders	<b>1,061</b>	914
	<b>7,640</b>	7,543
<b>Amounts due after more than one year</b>		
Other creditors	<b>78</b>	52

Included in other creditors are amounts totalling \$138m (2003 \$104m) to meet insurance obligations of the Group's insurance subsidiaries. Also in other creditors are amounts due within one year in connection with the Group's exceptional charges, including \$39m (2003 \$54m) in respect of the Agrochemicals demerger and Specialties disposal.

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**17 Loans**

	Repayment dates	2004 \$m	2003 \$m
<b>Unsecured loans</b>			
US dollars			
7% Guaranteed debentures	2023	283	295
5.4% Callable bond	2014	747	
Others	2013		8
<b>Total unsecured</b>		<b>1,030</b>	<b>303</b>
Less: current instalments of loans			
Loans due after more than one year		<b>1,030</b>	<b>303</b>

In the above table, loans are shown after taking account of associated cross-currency swaps (see Note 18). During the year, a 5.4% callable bond was issued for proceeds, net of expense, of \$747m.

There are no loans from banks included in the table above (2003 \$nil).

**18 Financial instruments**

The Group's objectives, policies and strategy in respect of risk management and the use of financial instruments are described in the Financial Review. The following disclosures exclude all short term, trade related debtors and creditors.

**Interest rate risks of financial assets and liabilities**

The interest rate profile, after taking into account interest and cross-currency swaps, of the financial assets and liabilities of the Group as at 31 December 2004 was:

	Floating rate \$m	Fixed rate \$m	Financial assets/liabilities on which no interest is paid/received \$m	Total \$m	Weighted average fixed interest rate %	Weighted average period for which rate is fixed Years
<b>Financial liabilities</b>						
US dollar	1,159			<b>1,159</b>		

Other	13		<b>13</b>
	1,172		<b>1,172</b>
<b>Financial assets</b>			
US dollar	4,772	10	<b>4,782</b>
Euro	4		<b>4</b>
Sterling	127	252	<b>379</b>
SEK	2	18	<b>20</b>
Other	228		<b>228</b>
	5,133	280	<b>5,413</b>

The floating rate financial liabilities comprise largely of fixed rate debt that has been swapped into floating rate debt. During the year, the Group restructured its external debt. A \$300m US dollar bond was partially re-purchased and cancelled, with the remaining balance swapped into floating rate until maturity. In addition, the Group issued a \$750m US dollar fixed rate bond under a \$4bn SEC registered shelf programme. The bond matures in 2014 and has been swapped to floating rate until maturity. The financial liabilities also include \$142m of short term bank borrowings and overdrafts, bearing interest at rates fixed by reference to local interbank rates.

The financial assets principally comprise cash on overnight deposit or held directly with third party fund managers and short term investments with an average maturity of 27 days. These include deposits where the interest rate is fixed until maturity but, as the original maturity is less than one year, they are classified as floating rate financial instruments. The main benchmark rates for euro and US dollar financial assets are the relevant LIBID rates. Financial assets include \$267m of other fixed asset investments on which no interest is received.

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## Notes to the Financial Statements continued

### 18 Financial instruments (continued)

#### Currency exposures

100% of the Group's major transactional currency exposures on working capital balances, which typically extend for up to three months, are hedged using forward foreign exchange contracts. As a result, as at 31 December 2004 and 31 December 2003, there were no material monetary assets or liabilities in currencies other than the functional currencies of the Group companies concerned, having taken into account the effect of forward exchange currency contracts that have been used to match foreign currency exposures.

Additionally, approximately 95% of forecast future foreign currency transaction exposures on major currencies extending for 12 months were hedged to cover movements outside specified limits. The principal currency exposures (sterling, Swedish kronor (SEK) and euros) were hedged using a mixture of purchased currency options and forward foreign exchange contracts. As at 31 December 2004, the forecast future foreign currency transaction exposures were:

	<b>2004 Forecast exposures \$m</b>	2003 Forecast exposures \$m
Sterling payables	<b>2,553</b>	2,517
SEK payables	<b>1,551</b>	1,442
Euro receivables	<b>1,926</b>	2,194

#### Maturity of financial liabilities

The maturity profile of the Group's financial liabilities, other than short term creditors such as trade creditors and accruals, at 31 December 2004 was as follows:

Analysis by year of repayment	2004			2003		
	Loans \$m	Other \$m	Total \$m	Loans \$m	Other \$m	Total \$m
After five years	<b>1,030</b>		<b>1,030</b>	303		303

From five to four years

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From four to three years

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From three to two years

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From two to one years

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Due after more than one year	<b>1,030</b>		<b>1,030</b>	303		303
Due within one year		<b>142</b>	<b>142</b>		152	152
	<b>1,030</b>	<b>142</b>	<b>1,172</b>	303	152	455

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Other financial liabilities comprise short term bank borrowings and overdrafts.

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**18 Financial instruments (continued)****Borrowing facilities**

The Group currently relies on its cash balances and short term investments (excluding investment securities) of \$4,990m and long term debt of \$1,030m to manage liquidity risk.

**Fair values of financial assets and financial liabilities**

Set out below is a comparison by category of carrying values and fair values of all the Group's financial assets and financial liabilities as at 31 December 2004 and 31 December 2003.

	<b>2004</b> <b>Carrying</b> <b>value</b> <b>\$m</b>	<b>2004</b> <b>Fair</b> <b>value</b> <b>\$m</b>	2003 Carrying value \$m	2003 Fair value \$m
<b>Primary financial instruments</b>				
Short term borrowings and overdrafts	(142)	(142)	(152)	(152)
Loans	(1,030)	(1,126)	(303)	(371)
Cash	1,055	1,055	733	733
Short term investments	4,091	4,095	3,218	3,306
Fixed asset investments	267	262	220	217
<b>Derivative financial instruments held to manage the interest rate and currency profile</b>				
Cross-currency swaps and interest rate swaps		71		56
<b>Derivative financial instruments held or issued to hedge the currency exposure on existing transactions</b>				
Forward foreign exchange contracts	9	10	12	12
<b>Derivative financial instruments held or issued to hedge the currency exposure on expected future transactions</b>				
Forward foreign exchange contracts				(19)
Foreign currency option contracts	22	32	77	148





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## Notes to the Financial Statements continued

### 18 Financial instruments (continued)

The methods and assumptions used to estimate the fair values of financial instruments are as follows:

- a. Short term investments the fair value of listed investments is based on year end quoted market prices. For unlisted investments, carrying values approximate fair value.
- b. Fixed asset investments (excluding equity investments in joint ventures and associates) the fair value of listed investments is based on year end quoted market prices. For unlisted investments, carrying values approximate fair value.
- c. Loans the fair value of publicly traded debt is based on year end quoted market prices; the fair value of floating rate debt is nominal value, as mark to market differences would be minimal given frequency of resets; the fair value of remaining debt is estimated using appropriate zero coupon valuation techniques based on rates current at year end.
- d. Forward foreign exchange contracts the Group has forward foreign exchange contracts to sell currency for the purpose of hedging non-dollar commercial transaction exposures which existed at the date of the balance sheet and to hedge anticipated, but not firmly committed, non-dollar commercial transactions for 2005. The majority of the contracts for existing transactions had a maturity of six months or less from year end. The fair value of forward foreign exchange contracts is based on market forward foreign exchange rates at year end.
- e. Foreign currency option contracts the Group has foreign currency option contracts to hedge anticipated, but not firmly committed, non-dollar commercial transactions for 2005. The fair value of option contracts is estimated using Black-Scholes valuation techniques.
- f. Interest rate and cross-currency swaps AstraZeneca uses interest rate and cross-currency swaps to hedge the Group's exposure to fluctuations in interest rates and foreign exchange movements on borrowings, in accordance with a formal risk management strategy. The fair value is estimated using appropriate zero coupon valuation techniques based on rates current at year end.

The above financial instruments are subject to credit and market risk. AstraZeneca contains credit risk through the use of counterparty and product specific credit limits and by ongoing review procedures. All financial instruments are transacted with commercial banks and, in line with standard market practice, are not backed with cash collateral. The notional principal values of off balance sheet financial instruments do not represent amounts exchanged by the parties and are not a measure of the credit risk to the Group of these instruments. The credit risk of these instruments is limited to the positive fair values of such contracts.

Market risk is the sensitivity of the value of financial instruments to changes in related currency and interest rates. The Group is not exposed to material market risk because gains and losses on the derivative financial instruments are largely offset by gains and losses on the underlying assets, liabilities and transactions subject to hedge.

#### Hedges

As noted on page 92, the Group's policy is to hedge 100% of transactional currency exposures and approximately 95% of forecast future transaction exposures using forward foreign exchange contracts and foreign currency option contracts. It also uses cross-currency and interest rate swaps to manage the profile of its borrowings.

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Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging are as follows:

	Gains \$m	Losses \$m	Total net gains \$m
Unrecognised gains and losses on hedges at 1 January 2004	129	(21)	108
Gains and losses arising in previous years that were recognised in 2004	105	(21)	84
Gains and losses arising in previous years that were not recognised in 2004	24		24
<b>Unrecognised gains and losses on hedges at 31 December 2004</b>	<b>83</b>	<b>(1)</b>	<b>82</b>
Gains and losses expected to be recognised in 2005	33	(1)	32
Gains and losses expected to be recognised in 2006 or later	50		50

**19 Provisions for liabilities and charges**

	Employee benefits \$m	Pensions \$m	Environmental, litigation and other provisions \$m	Deferred taxation \$m	Total \$m
At 1 January 2003	139	234	190	1,210	1,773
Profit and loss account	50	72	48	232	402
Net amounts paid or becoming current	(57)	(57)	(65)		(179)
Other movements, including exchange	58	34	30	148	270
At 31 December 2003	190	283	203	1,590	2,266
Profit and loss account	17	56	(2)	(46)	25
Net amounts paid or becoming current	(52)	(64)	(71)		(187)
Other movements, including exchange	22	29	15	37	103
<b>At 31 December 2004</b>	<b>177</b>	<b>304</b>	<b>145</b>	<b>1,581</b>	<b>2,207</b>

Employee benefit provisions comprise post-retirement and other employee benefit provisions. Further details of environmental provisions are given in Note 30.

No provision has been released or applied for any purpose other than that for which it was established.

**20 Reconciliation of movements in shareholders funds**

	2004 \$m	2003 \$m	2002 \$m
Shareholders funds at beginning of year	13,178	11,172	9,586
Net profit for the financial year	3,813	3,036	2,836
Dividends	(1,555)	(1,350)	(1,206)
Profit retained for the financial year	2,258	1,686	1,630
Issues of AstraZeneca PLC Ordinary Shares	102	47	36

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Re-purchase of AstraZeneca PLC Ordinary Shares	<b>(2,212)</b>	(1,154)	(1,190)
Foreign exchange adjustments on consolidation, net of tax	<b>1,092</b>	1,427	1,106
Translation differences on foreign currency borrowings			6
Tax on translation differences on foreign currency borrowings			(2)
Net addition to shareholders funds	<b>1,240</b>	2,006	1,586
Shareholders funds at end of year	<b>14,418</b>	13,178	11,172

Included in foreign exchange adjustments on consolidation, is a tax credit in 2004 of \$357m in respect of foreign exchange loss deductions arising in 2000 (see Note 5).

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## Notes to the Financial Statements continued

## 21 Reserves

	Share premium account \$m	Capita redemption reserve \$m	Merge reserve \$m	Other reserves \$m	Joint ventures and associates \$m	Profit and loss account \$m	Total \$m
<b>At 31 December 2001</b>	<b>334</b>	<b>9</b>	<b>433</b>	<b>1,653</b>	<b>(183)</b>	<b>6,904</b>	<b>9,150</b>
Profit retained for year						1,630	1,630
Share premiums	36						36
Transfer between reserves	33					(33)	
Re-purchase of shares		7				(1,190)	(1,183)
Exchange adjustments:							
Goodwill				(30)		30	
Foreign exchange adjustments on consolidation, net of tax						1,106	1,106
On foreign currency borrowings						6	6
Foreign currency borrowings tax effect						(2)	(2)
				(30)		1,140	1,110
Net movements	69	7		(30)		1,547	1,593
<b>At 31 December 2002</b>	<b>403</b>	<b>16</b>	<b>433</b>	<b>1,623</b>	<b>(183)</b>	<b>8,451</b>	<b>10,743</b>
Profit retained for year						1,686	1,686
Share premiums	46						46
Re-purchase of shares		7				(1,154)	(1,147)
Exchange adjustments:							

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Goodwill				(39)		39	
Foreign exchange adjustments on consolidation, net of tax						1,427	1,427
				(39)		1,466	1,427
Net movements	46	7		(39)		1,998	2,012
<b>At 31 December 2003</b>	<b>449</b>	<b>23</b>	<b>433</b>	<b>1,584</b>	<b>(183)</b>	<b>10,449</b>	<b>12,755</b>
Profit retained for year						2,258	2,258
Share premiums	101						101
Re-purchase of shares		13				(2,212)	(2,199)
Exchange adjustments:							
Goodwill				(19)		19	
Foreign exchange adjustments on consolidation, net of tax						1,092	1,092
				(19)		1,111	1,092
Net movements	101	13		(19)		1,157	1,252
<b>At 31 December 2004</b>	<b>550</b>	<b>36</b>	<b>433</b>	<b>1,565</b>	<b>(183)</b>	<b>11,606</b>	<b>14,007</b>

The cumulative amount of goodwill written off directly to reserves resulting from acquisitions, net of disposals, prior to the adoption of FRS 10 in 1998, amounted to \$675m (2003 \$656m, 2002 \$617m) using year end rates of exchange. At 31 December 2004, under UITF 38, 1,137,335 treasury shares, at a cost of \$45m, have been written off to reserves.

There are no significant statutory or contractual restrictions on the distribution of current profits of subsidiaries, joint ventures or associates; undistributed profits of prior years are, in the main, permanently employed in the businesses of these companies. The undistributed income of AstraZeneca companies overseas may be liable to overseas taxes and/or UK taxation (after allowing for double taxation relief) if they were to be distributed as dividends (see Note 5).

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**22 Net cash inflow from trading operations**

	2004 \$m	2003 \$m	2002 \$m
Operating profit before exceptional items	4,770	4,111	4,356
Depreciation, amortisation and impairment	1,268	1,290	960
Stocks decrease/(increase)	129	(131)	101
Debtors increase	(209)	(540)	(198)
Creditors increase/(decrease)	71	(430)	402
Other non-cash movements including exchange	40	317	65
	<b>6,069</b>	4,617	5,686

**23 Cash outflow related to exceptional items**

	2004 \$m	2003 \$m	2002 \$m
Current period cash flow related to exceptional items			
Synergy and integration costs		(25)	(68)
Zoladex OIG settlement		(355)	
Costs relating to disposals and demerger of other businesses	(8)	(11)	(25)
<b>Outflow related to exceptional items</b>	<b>(8)</b>	<b>(391)</b>	<b>(93)</b>

Details of the cash inflows in connection with the profit on the sale of an interest in a joint venture are set out in Note 24.

**24 Disposal of business operations**

	2004 \$m	2003 \$m	2002 \$m
Fixed assets	2	70	



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Current assets	17	34
<hr/>		
Creditors due within one year	(7)	(17)
<hr/>		
Book value of net assets disposed	12	87
<hr/>		
Disposal costs	72	
<hr/>		
Profit on disposals	274	
<hr/>		
Less:		
Cash included in undertakings disposed	(3)	(7)
<hr/>		
<b>Cash consideration</b>	<b>355</b>	<b>80</b>
<hr/>		

The cash consideration is in relation to the sale of the Group's share of the joint venture Advanta BV, which was completed on 1 September 2004 (\$284m) and the disposal of the Durascan business in the first half of the year (\$71m). The profit on disposal is stated after transaction costs and warranty provisions.

The sale consideration received in 2003 was in relation to the sale of Marlow Foods Limited, which was completed on 23 May 2003.

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## Notes to the Financial Statements continued

## 25 Reconciliation of net cash flow to movement in net funds

	2004 \$m	2003 \$m	2002 \$m
<b>Increase/(decrease) in cash</b>	<b>309</b>	(4)	(22)
Cash (inflow)/outflow from (increase)/decrease in loans and short term borrowings	(727)	345	118
Cash outflow/(inflow) from increase/(decrease) in short term investments	862	(771)	806
Change in net funds resulting from cash flows	444	(430)	902
Exchange movements	34	82	75
Movement in net funds	478	(348)	977
Net funds at 1 January	3,496	3,844	2,867
<b>Net funds at 31 December</b>	<b>3,974</b>	3,496	3,844

## 26 Analysis of net funds

	At 1 Jan 2004 \$m	Cash flow \$m	Other non-cash \$m	Exchange movements \$m	At 31 Dec 2004 \$m
Loans due after one year	(303)	(725)		(2)	(1,030)
Current instalments of loans					
Total loans	(303)	(725)		(2)	(1,030)
Short term investments and fixed deposits	3,218	862		11	4,091
Cash	733	296		26	1,055
Overdrafts	(152)	13		(1)	(140)
Short term borrowings		(2)			(2)
	3,799	1,169		36	5,004
<b>Net funds</b>	3,496	444		34	3,974

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Financing items included in cash movements above:

Issue of AstraZeneca PLC Ordinary Shares	(102)
Re-purchase of AstraZeneca PLC Ordinary Shares	2,212
<b>Net cash inflow before management of liquid resources and financing</b>	<b>2,554</b>

**27 Financing**

	Notes	2004 \$m	2003 \$m	2002 \$m
Issue of AstraZeneca PLC Ordinary Shares	26	102	47	36
Re-purchase of AstraZeneca PLC Ordinary Shares	26	(2,212)	(1,154)	(1,190)
		(2,110)	(1,107)	(1,154)
New loans		746		
Loans repaid		(21)	(345)	(105)
Net increase/(decrease) in short term borrowings		2		(13)
		727	(345)	(118)
Net cash outflow from financing		(1,383)	(1,452)	(1,272)

There were no major non-cash financing transactions in any year.

[Back to Contents](#)**28 Post-retirement benefits****Pensions****Background**

The Group continues to account for pension costs in its primary Financial Statements in accordance with the UK Statement of Standard Accounting Practice No. 24 Pension Costs (SSAP 24). In addition, disclosures have been presented below in accordance with Financial Reporting Standard No. 17 Retirement Benefits (FRS 17).

The Company and most of its subsidiaries offer retirement plans which cover the majority of employees in the Group. Many of these plans are defined contribution where the company contribution and resulting profit and loss account charge is fixed at a set level or is a set percentage of employees pay. However, several plans, mainly in the UK, the US and Sweden, are defined benefit, where benefits are based on employees length of service and average final salary (typically averaged over 1, 3 or 5 years). All of the major plans are funded through legally separate trustee administered funds. The major defined benefit plans, apart from the collectively bargained Swedish plan, have been closed to new entrants since 2000. The cash funding of the plans, which may from time to time involve special payments, is designed, in consultation with independent qualified actuaries, to ensure that the assets together with future contributions should be sufficient to meet future liabilities.

The Group is currently performing a global review of its asset strategies with a view to producing a more globally consistent investment strategy for each of the Group's major funds. This has been completed in the UK and is nearing completion in the US, Sweden and Japan.

**SSAP 24**

The cost of defined benefit plan pensions in a year can notionally be divided into the regular cost and variations from the regular cost. Under SSAP 24 the regular cost is based on actuarial assumptions and charged to the profit and loss account in the year it is incurred whilst any variations, which arise where the experience of the scheme varies from the assumptions made by the actuary, are charged or credited over the estimated remaining service lives of the employees. Costs of defined contribution plan pensions are charged to the profit and loss account immediately. On these bases, the total pension cost for the Group under SSAP 24 for 2004 was \$266m (2003 \$272m, 2002 \$220m). In the Group balance sheet at 31 December 2004, accrued pension costs included in other creditors amounted to \$111m (2003 \$143m); prepaid pension costs of \$660m (2003 \$628m) are included in debtors. Provisions for unfunded pension obligations, included in provisions, amounted to \$304m (2003 \$283m).

**UK**

With regard to the Group's main UK defined benefit fund, the latest full actuarial valuation was carried out at 31 March 2003 and the pension cost assessed using the projected unit credit method. The key accounting assumptions for the purposes of SSAP 24 were that, against a background of long term UK price inflation averaging 2.4% pa, investment returns would average 6.6% pa, salary increases 3.7% pa and pension increases 2.4% pa. The market value of the fund's assets at the valuation date was £2,043m (\$3,640m equivalent), representing 89.1% of the liabilities using these assumptions. The cost for accounting purposes equates to 21.1% of pensionable salaries. At the same

time, the valuation was carried out for ongoing funding purposes, with assumptions slightly more conservative than those used for SSAP 24 purposes. The market value of the fund's assets at the valuation date represents 87.4% of the liabilities on a funding basis. The Company had indicated to the trustee of the UK fund its intention to target a solvency ratio of 91% following the March 2003 actuarial valuation. A \$165m contribution was made in November 2003 which took the solvency ratio to 95%. An interim valuation was performed by the fund's actuaries, at 31 March 2004. The key accounting assumptions, set out in a manner consistent with the 2003 valuation, were revised having regard to the investment conditions at 31 March 2004. The long term UK price inflation was set at 2.75% pa, salary increases at 4.0% pa, pension increases at 2.75% pa and investment returns at 6.9% pa. The market value of the fund's assets at the valuation date was £2,453m (\$4,502m equivalent) representing a solvency ratio of 96.1% on the fund's liabilities. The longer term aim is to restore solvency over a period of around 15 years. Any cash contributions made to the fund are treated as prepayments and taken into account in the actuarially assessed contributions to the fund charged to the profit and loss account.

### **US**

The US defined benefits programme was actuarially revalued at 31 December 2004 when plan obligations were estimated to amount to \$1,199m and plan assets were \$1,064m. The US typically makes contributions to mitigate for plan benefit deficits on a regular basis.

### **Sweden**

The Swedish defined benefits programme was actuarially revalued at 31 December 2004 when plan obligations were estimated to amount to \$651m and plan assets were \$539m.

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## Notes to the Financial Statements continued

### 28 Post-retirement benefits (continued)

#### Post-retirement benefits other than pensions

In the US, and to a lesser extent in some other countries, AstraZeneca's employment practices include the provision of healthcare and life insurance benefits for retired employees. Some 3,758 retired employees and covered dependants currently benefit from these provisions and some 14,554 current employees will be eligible on retirement. AstraZeneca accrues for the present value of such retiree obligations over the working life of the employee.

The cost of post-retirement benefits other than pensions for the Group in 2004 was \$11m (2003 \$10m, 2002 \$22m). Provisions and creditors set aside for the benefit obligations at 31 December 2004 amounted to \$22m (2003 \$28m, 2002 \$32m). Other than these provisions and creditors there were plan assets amounting to \$217m in the US at 31 December 2004. These benefit plans have been included in the disclosure of post-retirement benefits under FRS 17.

#### FRS 17

Full implementation of FRS 17 had originally been intended for accounting periods ending on or after 22 June 2003 but has been deferred by the Accounting Standards Board until accounting periods commencing on or after 1 January 2005. However, the requirements for disclosure under FRS 17 between its issue and full implementation dates remain and this information is set out below. When fully adopted, the objective of FRS 17 is to reflect the fair value of post-retirement plan assets and liabilities and associated charges in the Financial Statements. FRS 17 specifies how key assumptions should be formulated and applied; these assumptions are often different to the funding bases established by the pension funds' trustees or actuaries. The accounting requirements of FRS 17 are broadly as follows:

- > Post-retirement scheme assets are valued at market values at the balance sheet date;
- > Post-retirement scheme liabilities are measured using a projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability; and
- > The movement in the scheme surplus/deficit (excluding contributions) will be split between operating charges and financing items in the profit and loss account and, in the statement of total recognised gains and losses, actuarial gains and losses.

The FRS 17 financial information presented in AstraZeneca's 2003 Annual Report was based on the position and performance of the Group's main defined benefit schemes. Typically this included information for schemes in the UK, the US, Sweden, Germany and Japan. In order to provide a more complete presentation, AstraZeneca has collected information on all of the Group's global defined benefit schemes. The 2003 information presented below has been recalculated on that basis.

#### Financial assumptions

Qualified independent actuaries have updated the actuarial valuations of the major defined benefit schemes operated by the Group to 31 December 2004. The assumptions used by the actuaries are chosen from a range of possible actuarial assumptions which, due to the long term nature of the scheme, may not necessarily be borne out in practice. These assumptions were as follows:

	2004		2003	
	UK	Rest of Group	UK	Rest of Group
Inflation assumption	2.7%	2.4%	2.6%	2.3%
Rate of increase in salaries	3.9%	3.9%	3.9%	4.3%
Rate of increase in pensions in payment	2.7%	0.7%	2.6%	0.6%

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Discount rate	<b>5.3%</b>	<b>5.1%</b>	5.4%	5.3%
Long term rate of return expected at 31 December				
Equities	<b>8.3%</b>	<b>8.6%</b>	8.3%	8.7%
Bonds	<b>5.1%</b>	<b>5.3%</b>	5.1%	5.8%
Others	<b>5.6%</b>	<b>4.7%</b>	4.2%	3.9%

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**28 Post-retirement benefits (continued)****Post-retirement scheme deficit**

The post-retirement scheme deficit set out below under FRS 17 is as if this standard were fully applied. However, under the current accounting methodology (SSAP 24) there are prepayments and provisions (including deferred tax) within the balance sheet at 31 December 2004 that must be taken into account in calculating the effect on net assets of this deficit in the event of a restatement under FRS 17.

The assets and liabilities of the major defined benefit schemes operated by the Group at 31 December 2004 as calculated in accordance with FRS 17 are shown below. The fair values of the schemes' assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present value of the schemes' liabilities is derived from cash flow projections over long periods and is thus inherently uncertain. If FRS 17 had been adopted for the year ended 31 December 2004, the Group's reported net assets (see page 74) would be reduced by \$1,369m (9.4%) to \$13,150m. Further explanation of this adjustment is included below:

	Value at 31 December 2004			Value at 31 December 2003		
	UK \$m	Rest of Group \$m	Total \$m	UK \$m	Rest of Group \$m	Total \$m
<b>Scheme assets</b>						
Equities	2,083	1,488	<b>3,571</b>	1,779	1,182	2,961
Bonds	2,007	583	<b>2,590</b>	2,430	530	2,960
Others	927	101	<b>1,028</b>	109	87	196
<b>Total fair value of assets</b>	<b>5,017</b>	<b>2,172</b>	<b>7,189</b>	<b>4,318</b>	<b>1,799</b>	<b>6,117</b>
<b>Present value of scheme liabilities</b>	<b>(6,126)</b>	<b>(2,766)</b>	<b>(8,892)</b>	<b>(5,232)</b>	<b>(2,406)</b>	<b>(7,638)</b>
<b>Deficit in the scheme</b>	<b>(1,109)</b>	<b>(594)</b>	<b>(1,703)</b>	<b>(914)</b>	<b>(607)</b>	<b>(1,521)</b>
Related deferred tax asset	333	187	<b>520</b>	274	222	496
<b>Net post-retirement deficit under FRS 17</b>	<b>(776)</b>	<b>(407)</b>	<b>(1,183)</b>	<b>(640)</b>	<b>(385)</b>	<b>(1,025)</b>
<b>Adjustments for assets and provisions under SSAP 24</b>						
Prepayment, net of related deferred tax	(204)	(265)	<b>(469)</b>	(203)	(203)	(406)
Accrual, net of deferred tax		52	<b>52</b>	19	59	78



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Provision, net of deferred tax	18	213	<b>231</b>	155	155
<b>Adjusted post-retirement deficit, net of related deferred tax</b>	(962)	(407)	<b>(1,369)</b>	(824)	(1,198)
Net assets as currently disclosed (see page 74)			<b>14,519</b>		13,257
<b>Net assets as adjusted if FRS 17 were fully adopted</b>			<b>13,150</b>		12,059

The present value of the UK scheme's liabilities has increased to \$6,126m from \$5,232m in 2003. This increase has been driven in part by the changes in financial assumptions detailed on page 100. There has also been an exchange effect of approximately \$271m on these liabilities during the year.

95% of the Group's liabilities at 31 December 2004 are in schemes within the UK, the US, Sweden, Germany and Japan.

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## Notes to the Financial Statements continued

### 28 Post-retirement benefits (continued)

#### Profit and loss account disclosures

On full adoption of FRS 17, on the basis of the above assumptions, the amounts that would have been charged to the consolidated profit and loss account and statement of total recognised gains and losses, in respect of defined benefit schemes for the year ended 31 December 2004 are set out below:

	2004			2003		
	UK \$m	Rest of Group \$m	Total \$m	UK \$m	Rest of Group \$m	Total \$m
<b>Operating profit</b>						
Current service cost	(124)	(116)	<b>(240)</b>	(110)	(91)	(201)
Past service costs					(2)	(2)
Total operating charge	(124)	(116)	<b>(240)</b>	(110)	(93)	(203)
<b>Finance expense</b>						
Expected return on post-retirement scheme assets	278	112	<b>390</b>	211	66	277
Interest on post-retirement scheme liabilities	(283)	(118)	<b>(401)</b>	(239)	(91)	(330)
Net return	(5)	(6)	<b>(11)</b>	(28)	(25)	(53)
Charge before taxation	(129)	(122)	<b>(251)</b>	(138)	(118)	(256)
<b>Consolidated statement of total recognised gains and losses</b>						
Actual return less expected return on the post-retirement schemes assets	138	54	<b>192</b>	210	75	285
Experience losses arising on the post-retirement schemes liabilities	(57)	(9)	<b>(66)</b>	(6)	(33)	(39)
Changes in assumptions underlying the present value of the post-retirement schemes liabilities	(159)	(74)	<b>(233)</b>	(350)	(116)	(466)
Actuarial loss recognised	(78)	(29)	<b>(107)</b>	(146)	(74)	(220)

#### History of experience gains and losses for the year ended 31 December 2004

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	2004			2003		
	UK \$m	Rest of Group \$m	Total \$m	UK \$m	Rest of Group \$m	Total \$m
<b>Difference between the expected and actual return on scheme assets:</b>						
Amount	138	54	<b>192</b>	210	75	285
Percentage of scheme assets	2.8%	2.5%	<b>2.7%</b>	4.9%	4.2%	4.7%
<b>Experience gains and losses on scheme liabilities:</b>						
Amount	(57)	(9)	<b>(66)</b>	(6)	(33)	(39)
Percentage of the present value of scheme liabilities	1.0%	0.3%	<b>0.7%</b>	0.1%	1.4%	0.5%
<b>Total amount recognised in statement of total recognised gains and losses:</b>						
Amount	(78)	(29)	<b>(107)</b>	(146)	(74)	(220)
Percentage of the present value of scheme liabilities	1.3%	1.0%	<b>1.2%</b>	2.8%	3.1%	2.9%

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**28 Post-retirement benefits (continued)****Movement in post-retirement scheme deficit during the year ended 31 December 2004**

	2004			2003		
	UK \$m	Rest of Group \$m	Total \$m	UK \$m	Rest of Group \$m	Total \$m
Deficits in schemes at beginning of year	(914)	(607)	<b>(1,521)</b>	(842)	(585)	(1,427)
Current service cost	(124)	(116)	<b>(240)</b>	(110)	(91)	(201)
Contributions	97	193	<b>290</b>	299	243	542
Past service cost					(2)	(2)
Settlement and curtailment						
Other finance income	(5)	(6)	<b>(11)</b>	(28)	(25)	(53)
Actuarial loss	(78)	(29)	<b>(107)</b>	(146)	(74)	(220)
Exchange	(85)	(29)	<b>(114)</b>	(87)	(73)	(160)
Deficits in schemes at end of year	(1,109)	(594)	<b>(1,703)</b>	(914)	(607)	(1,521)
Adjusted post-retirement deficit, net of deferred tax			<b>(1,369)</b>			(1,198)

The increase in the deficit during 2004 reflects changes in assumptions in calculating liabilities (principally in the UK funds) and exchange movements offset by contributions made to the funds and better actual returns on plan assets than expected.

**Reserves note for the year ended 31 December 2004**

	2004 Total \$m	2003 Total \$m
Profit and loss reserve excluding post-retirement liability	<b>11,606</b>	10,449
Post-retirement reserve	<b>(1,369)</b>	(1,198)
Profit and loss reserve under FRS 17	<b>10,237</b>	9,251



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## Notes to the Financial Statements continued

### 29 Employee costs and share option plans for employees

#### Employee costs

The average number of people employed by the Group is set out in the table below. In accordance with the Companies Act 1985, this includes part-time employees:

Employees	2004	2003	2002
Average number of people employed by the Group in:			
UK	11,500	11,100	10,900
Continental Europe	25,600	23,900	23,500
The Americas	18,500	17,900	17,800
Asia, Africa & Australasia	8,600	8,100	7,200
Continuing operations	64,200	61,000	59,400

The number of people employed by the Group at the end of 2004 was 64,200 (2003 62,600, 2002 59,200).

The costs incurred during the year in respect of these employees were:

	2004 \$m	2003 \$m	2002 \$m
Salaries	4,078	3,587	3,022
Social security costs	644	526	505
Pension costs	266	272	220
Other employment costs	303	360	246
	5,291	4,745	3,993

Employee costs above do not include severance costs.

The Directors believe that, together with the basic salary system, the Group's employee incentive schemes provide competitive and market-related packages to motivate employees. They should also align the interests of employees with those of shareholders, as a whole, through long term share ownership in the Company. The Group's current UK, Swedish and US schemes are described below; other arrangements apply elsewhere.

**The AstraZeneca UK Performance Bonus Plan**

Employees of participating AstraZeneca UK companies are invited to participate in this bonus plan which rewards strong individual performance. Bonuses are paid partly in the form of Ordinary Shares in the Company (under the Inland Revenue approved AstraZeneca All-Employee Share Plan and up to a maximum annual value of £3,000) and partly in cash. A tax efficient share retention scheme, under which employees leave their bonus shares in trust for three to five years, forms part of the All-Employee Share Plan. The Company also offers UK employees the opportunity to buy Partnership Shares (Ordinary Shares) under the All-Employee Share Plan. Employees may invest up to £1,500 over a 12 month accumulation period and purchase Partnership Shares in the Company with the total proceeds at the end of the period. The purchase price for the shares is the lower of the price at the beginning or the end of the 12 month period. A tax efficient share retention scheme is also available in respect of Partnership Shares. At the Company's AGM in 2002, shareholders approved the issue of new shares for the purposes of the All-Employee Share Plan.

**The AstraZeneca Executive Annual Bonus Scheme**

This scheme is a performance bonus scheme for Directors and senior employees who do not participate in the AstraZeneca UK Performance Bonus Plan. Annual bonuses are paid in cash and reflect both corporate and individual performance measures. The Remuneration Committee has discretion to reduce or withhold bonuses if business performance falls sufficiently short of expectations in any year such as to make the payment of bonuses inappropriate.

**The AstraZeneca Savings-Related Share Option Scheme and the AstraZeneca Savings-Related Share Option Plan**

UK employees may make regular monthly savings contributions over a three or five year period and may apply for options to acquire AstraZeneca Ordinary Shares. Further details are set out below.

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[Back to Contents](#)**29 Employee costs and share option plans for employees (continued)****The AstraZeneca Share Option Plan**

This is a share option plan for employees of participating AstraZeneca Group companies which was approved by shareholders at the Company's AGM in 2000. The first grant of options occurred in August 2000. The main grant of options in 2004 under the plan was in March, with a further, smaller grant in August. The Remuneration Committee sets the policy for the Company's operation of the plan. Further details are set out below.

**Sweden**

In Sweden an all employee performance bonus plan is in operation. The plan rewards strong performance at corporate, function and individual/team level. Bonuses for corporate and function performance are always paid in the form of AstraZeneca Ordinary Shares. Bonuses for individual/team performance may be paid in Ordinary Shares or in cash, at the employee's discretion. Existing Ordinary Shares are used to pay bonuses awarded under the plan. These are purchased in the market. They must be left in trust for three years. The AstraZeneca Executive Annual Bonus Scheme and the AstraZeneca Share Option Plan both operate in respect of relevant AstraZeneca employees in Sweden.

**US**

In the US, there are two senior staff incentive schemes, under which either AstraZeneca ADSs or stock appreciation rights related to AstraZeneca ADSs are awarded to participants. There are currently approximately 140 participants in these schemes. AstraZeneca ADSs necessary to satisfy the awards under these schemes are purchased in the market and no subscriptions for new Ordinary Shares have been involved. The AstraZeneca Share Option Plan operates in respect of relevant AstraZeneca employees in the US.

**Share option plans**

At 31 December 2004, there were options outstanding under the Zeneca 1994 Executive Share Option Scheme, the Astra Shareholder Value Incentive Plan, the AstraZeneca Savings-Related Share Option Scheme, the AstraZeneca Savings-Related Share Option Plan and the AstraZeneca Share Option Plan.

**(1) Summary of the AstraZeneca Share Option Plan***Eligibility*

Any AstraZeneca employee may be recommended from time to time for the grant of an option. The Remuneration Committee sets the policy for the Company's operation of the plan including as regards which employees will be eligible to participate.

*Grant of options*

Options may be granted at any time other than during a close period. No options may be granted after the fifth anniversary of the approval of the plan by shareholders until the Remuneration Committee has reviewed the plan.

The grant of options is supervised by the Remuneration Committee which is comprised wholly of Non-Executive Directors. No payment is required for the grant of an option. Options are not transferable.



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Options may be granted over AstraZeneca Ordinary Shares or ADSs.

### *Acquisition price*

The price per Ordinary Share payable upon the exercise of an option will not be less than an amount equal to the average of the middle-market closing price for an Ordinary Share of the Company on the London Stock Exchange on the three consecutive dealing days immediately before the date of grant (or as otherwise agreed with the Inland Revenue). Where the option is an option to subscribe, the price payable upon exercise cannot be less than the nominal value of an Ordinary Share of the Company.

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## Notes to the Financial Statements continued

### 29 Employee costs and share option plans for employees (continued)

#### *Exercise of options*

An option will normally be exercisable between three and 10 years following its grant provided any relevant performance condition has been satisfied. Options may be satisfied by the issue of new Ordinary Shares or by existing Ordinary Shares purchased in the market.

The Remuneration Committee sets the policy for the Company's operation of the plan including as regards whether any performance target(s) will apply to the grant and/or exercise of each eligible employee's option.

Options normally lapse on cessation of employment. Exercise is, however, permitted for a limited period following cessation of employment either for reasons of injury or disability, redundancy or retirement, or at the discretion of the Remuneration Committee, and on an amalgamation, take-over or winding-up of the Company.

#### **(2) Summary of the AstraZeneca Savings-Related Share Option Scheme and the AstraZeneca Savings-Related Share Option Plan**

The AstraZeneca Savings-Related Share Option Scheme was approved by shareholders in 1994 for a period of 10 years. The last grant of options under this scheme was made in September 2002.

In 2003, shareholders approved the AstraZeneca Savings-Related Share Option Plan for a period of 10 years. The first grant of options under this plan was made in September 2003.

The following sections apply to both the AstraZeneca Savings-Related Share Option Scheme and the AstraZeneca Savings-Related Share Option Plan, which have broadly similar rules.

#### *Eligibility*

UK resident employees of participating AstraZeneca companies are automatically eligible to participate.

#### *Grant of options*

Invitations to apply for options may be issued within six weeks after the announcement by the Company of its results for any period and at other times in circumstances considered to be exceptional by the Directors. No invitations may be issued later than 10 years after the approval of the scheme by shareholders.

Options may only be granted to employees who enter into UK Inland Revenue approved savings contracts with the savings body nominated by the Company, under which monthly savings of a fixed amount (currently not less than £5 nor more than £250) are made over a period of three or five years. The number of Ordinary Shares over which an option is granted will be such that the total amount payable on its exercise will be the proceeds on maturity of the related savings contract. No payment will be required for the grant of an option. Options are not transferable.

#### *Individual participation*

Monthly savings by an employee under all savings contracts linked to options granted under any SAYE scheme may not exceed £250 or such lower amounts as may be determined by the Directors.

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### *Acquisition price*

The price per Ordinary Share payable upon the exercise of an option will not normally be less than the higher of:

- (a) 90% of the arithmetical average of the middle-market quotations for an Ordinary Share on the London Stock Exchange on three consecutive dealing days shortly before the date on which invitations to apply for options are issued (provided that no such day may fall before the Company last announced its results for any period) or such other dealing day or days falling within the six week period for the issue of invitations as the Directors may decide; and
  - (b) the nominal value of an Ordinary Share (unless the option is expressed to relate only to existing Ordinary Shares).
-

**29 Employee costs and share option plans for employees (continued)***Exercise of options*

An option will normally be exercisable only for six months commencing on the third or fifth anniversary of the commencement of the related savings contract. Options are satisfied by the issue of new Ordinary Shares.

Options normally lapse on cessation of employment. Exercise is, however, permitted for a limited period (irrespective of the period during which the option has been held) following cessation of employment in certain compassionate circumstances or where an option has been held for more than three years (except on dismissal for misconduct) and on an amalgamation, take-over or winding-up of the Company.

AstraZeneca has chosen to avail itself of the exemption to application of UITF17 to its SAYE schemes.

**(3) Summary of the Zeneca 1994 Executive Share Option Scheme**

The Zeneca 1994 Executive Share Option Scheme was introduced in 1994. The last date for the grant of options was 16 March 2000 and the scheme has been replaced by the AstraZeneca Share Option Plan.

Options granted under the 1994 scheme are normally exercisable between three and 10 years following grant, provided the relevant performance condition has been satisfied. Options are satisfied by the issue of new Ordinary Shares.

The performance condition applicable to the 1994 scheme was that earnings per share must have grown by at least the increase in the UK Retail Price Index over three years plus 3% per annum. Satisfaction of this condition was tested annually by reference to the audited financial statements. All options granted under the 1994 scheme have become exercisable, the performance conditions having been satisfied.

**(4) Summary of the Astra Shareholder Value Incentive Plan**

In 1996, Astra established a stock option plan for some 100 Astra employees in key senior positions. The plan is no longer used for the grant of options and has been superseded by the AstraZeneca Share Option Plan.

On completion of the merger with Zeneca, options in Astra shares granted under the plan were replaced by options to acquire a number of AstraZeneca Ordinary Shares based on the exchange ratio used in the exchange offers used to effect the AstraZeneca merger. The ratio of AstraZeneca options granted in respect of former Astra options was 0.5045 AstraZeneca options for each Astra option held.

**(5) Summary of the Zeneca 1993 Senior Staff Share Option Scheme**

The Zeneca 1993 Senior Staff Share Option Scheme was introduced at the time of the demerger of Zeneca from ICI in 1993. The last date for the grant of options was 19 May 1994 and the scheme was replaced by the Zeneca 1994 Executive Share Option Scheme. At 31 December 2004, there were no options outstanding under this scheme.

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## Notes to the Financial Statements continued

## 29 Employee costs and share option plans for employees (continued)

	AstraZeneca Share Option Plan		1994 Scheme		SAYE Schemes		ASVIP	
	Options 000	WAEP* pence	Options 000	WAEP* pence	Options 000	WAEP* pence	Shares under option 000	WAEP* SEK
<b>At 1 January 2002</b>								
Options outstanding	11,399	3236	9,938	2636	2,799	2459	965	375
<b>Movements during 2002</b>								
Options granted	10,658	3462			2,721	1756		
Options exercised	(22)	3214	(243)	2175	(469)	1888	(206)	317
Options forfeited	(637)	3298	(406)	2654	(986)	2735		
Options lapsed								
Weighted average fair value of options granted during the year		1186				559		
<b>At 31 December 2002</b>								
Options outstanding	21,398	3347	9,289	2647	4,065	1987	759	391
<b>Movements during 2003</b>								
Options granted	15,505	2232			551	2211		
Options exercised	(52)	2468	(358)	2423	(382)	2137	(151)	311
Options forfeited	(1,163)	3001	(571)	2695	(282)	2192	(1)	318
Options lapsed								
Weighted average fair value of options granted during the year		583				658		
<b>At 31 December 2003</b>								
Options outstanding	35,688	2874	8,360	2654	3,952	1988	607	411

**Movements during 2004**

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Options granted	10,741	2529			550	2262		
Options exercised	(329)	2787	(586)	2704	(113)	2184	(114)	321
Options forfeited	(1,964)	2886	(285)	2660	(276)	2199	(10)	474
Options lapsed								
Weighted average fair value of options granted during the year		650				632		
<b>At 31 December 2004</b>								
Options outstanding	44,136	2790	7,489	2650	4,113	2005	483	431
Range of exercise prices		1913p to 3487p		891p to 2749p		1756p to 2971p		411SEK to 442SEK
Weighted average remaining contractual life		2,852 days		1,814 days		1,058 days		258 days
Options exercisable	10,706	3203	7,489	2650	390	2373	483	431

\* Weighted average exercise price

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**30 Assets pledged, commitments and contingent liabilities**

	2004 \$m	2003 \$m	2002 \$m
<b>Assets pledged</b>			
Mortgages and other assets pledged			90
<b>Commitments</b>			
Contracts placed for future capital expenditure not provided for in these accounts	298	421	500

Included in the above total are contracts related to certain product purchase and licence agreements with deferred consideration obligations, the amounts of which are variable depending upon particular milestone achievements. Sales of the products to which these milestones relate could give rise to additional payments, contingent upon the sales levels achieved. Guarantees and contingencies arising in the ordinary course of business, for which no security has been given, are not expected to result in any material financial loss.

**Commitments**

In 1982 Astra AB set up a joint venture with Merck & Co., Inc. for the purposes of selling, marketing and distributing certain Astra products in the US. In 1998, this joint venture was restructured (the restructuring). Under the restructuring, a US limited partnership, in which Merck is the limited partner and AstraZeneca is the general partner, was set up and AstraZeneca obtained control of the joint venture's business subject to certain limited partner and other rights held by Merck and its affiliates. These rights provide Merck with safeguards over the activities of the partnership and place some limitations over AstraZeneca's discretion to operate with complete commercial freedom. The restructuring agreements provide for the following ongoing payment and termination arrangements:

- > Annual contingent payments
- > Partial Redemption
- > First Option
- > Second Option

In addition, included in the assets and liabilities covered by the restructuring is a loan note receivable by AstraZeneca from Merck with a face value of \$1.4bn. Each of these elements is discussed in further detail below.

Under the terms of the 1998 restructuring, the merger in 1999 between Astra and Zeneca triggered two one-time payments from AstraZeneca to Merck:

- > a Lump Sum Payment of \$809m, which was charged to the profit and loss account, as a result of which Merck relinquished any claims to Zeneca products; and
- > an Advance Payment of \$967m. This Advance Payment was calculated as the then net present value of \$2.8bn discounted from 2008 to the date of payment at a rate of 13% per annum and causes Merck to relinquish any rights, including contingent payments on future sales, to Astra products with no existing or pending US patents at the time of the merger. As the Advance Payment provides AstraZeneca with relief from future payments on these products (and relief from any other potential obligations or restrictions in respect of these products), this amount has been capitalised as an intangible asset and is being amortised over 20 years. The Advance Payment is subject to a true-up in 2008, as discussed under First Option below.

*Annual contingent payments*

AstraZeneca makes ongoing payments to Merck based on sales of certain of its products in the US (the contingent payments on the agreement products). As a result of the 1999 merger, these contingent payments (excluding those in respect of *Prilosec* and *Nexium*) cannot be less than annual minimum sums between 2002 and 2007 ranging from \$125m to \$225m. The payments have exceeded the minimum level in 2002 to 2004 and AstraZeneca has no reason to believe that the annual payments in the future will

fall below the minimum obligations.

*Partial Redemption*

In 2008, there will be a partial redemption of Merck's limited partnership interest which will end Merck's interests (including rights to contingent payments) in respect of certain of the agreement products by distribution to Merck of an amount calculated as a multiple of the average annual contingent payments from 2005 to 2007 on the relevant products, plus \$750m.

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## Notes to the Financial Statements continued

### 30 Assets pledged, commitments and contingent liabilities (continued)

#### *First Option*

In 2008, a calculation will be made of the Appraised Value, being the net present value of the future contingent payments in respect of all agreement products not covered by the Partial Redemption, other than *Prilosec* and *Nexium*. Payment of this amount to Merck in 2008 is, however, contingent on Merck's exercise of the First Option. Exercise of the First Option will require AstraZeneca to buy out Merck's interest in these products at the Appraised Value. Should Merck not exercise this option in 2008, AstraZeneca may exercise it in 2010 for a sum equal to the 2008 Appraised Value. If neither Merck nor AstraZeneca exercise the option, the contingent payment arrangements in respect of these agreement products will continue (as will other potential obligations and restrictions in respect of these products) and the Appraised Value will not be paid.

In addition, in 2008 there will be a true-up of the Advance Payment. The calculation of this will be based on a multiple of the average annual contingent payments from 2005 to 2007 in respect of all the agreement products with the exception of *Prilosec* and *Nexium* (subject to a minimum of \$6.6bn), plus other defined amounts (totalling \$912m). It is then reduced by the Appraised Value (whether paid or not), the Partial Redemption and the Advance Payment (at its undiscounted amount of \$2.8bn) to determine the true-up amount. The true-up will be settled in 2008 irrespective of whether the First Option is exercised and this could result in a further payment by AstraZeneca to Merck or a payment by Merck to AstraZeneca.

Should Merck exercise the First Option in 2008, AstraZeneca will make payments in respect of the Partial Redemption, the First Option and the true-up totalling a minimum of \$4.7bn. If AstraZeneca exercises the First Option in 2010, the combined effect will involve a minimum aggregate amount payable to Merck in 2008 and 2010 of the same amount.

#### *Loan Note Receivable*

In 2008, at the same time as the settlement of the Partial Redemption and the true-up, Merck will settle the loan note receivable by paying AstraZeneca \$1.4bn.

#### *Second Option*

A Second Option exists whereby AstraZeneca has the option to re-purchase Merck's interests in *Prilosec* and *Nexium* in the US. This option is exercisable by AstraZeneca two years after the exercise of the First Option, whether the First Option is exercised in either 2008 or 2010. Exercise of the Second Option by AstraZeneca at a later date is also provided for in 2017 or if combined annual sales of the two products fall below a minimum amount provided, in each case, that the First Option has been exercised. The exercise price for the Second Option is the fair value of these product rights as determined at the time of exercise.

If the Second Option is exercised, Merck will relinquish all its interests (including rights to contingent payments) in AstraZeneca products.

#### *Accounting treatment*

The precise amount of settlements with Merck under the Partial Redemption, the First Option and the true-up of the Advance Payment cannot be determined at this time. The Partial Redemption and true-up are calculated based, in part, on trading performance between 2005 and 2007, and payment of the First Option is contingent upon Merck (or AstraZeneca) exercising the First Option. If Merck exercises the First Option in 2008, the net minimum payment to be made to Merck, being the combined payments of \$4.7bn less the repayment of the loan note of \$1.4bn, would be \$3.3bn.

In accounting for the Restructuring in 1998, the loan note was included in the determination of the fair values of the assets and liabilities to be acquired. The loan note was ascribed a fair value of zero on acquisition and on the balance sheet because it is estimated that the net minimum payment of \$3.3bn equated to the fair value of the trading rights to be acquired under the Partial Redemption and First Option.

It is considered that the payments described under the headings above, including the Second Option, represent the acquisition of future trading rights which will terminate Merck's interests in the agreement products (including their rights to contingent payments)

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and which will provide AstraZeneca with unencumbered discretion in our operations in the US market. Merck's interests will only be terminated as and when the payments are made and, accordingly, the acquisition of these trading rights will only be reflected in the Financial Statements at that point. The trading rights will be accounted for under the extant guidance when the payments are made, with allocations to intangibles and goodwill, as appropriate.

As noted, the calculation of the purchase price of the trading rights is based partially on the contingent payments made in 2005 to 2007 (subject to the minimum amount) and is likely to be substantially driven by the sales of *Toprol-XL*, *Pulmicort*, *Rhinocort* and *Atacand*. However, AstraZeneca anticipates that the benefits that will accrue to the Company from these payments will begin to be realised from 2008 onwards based on contributions from those products that have already been launched (for example, *Rhinocort* and *Atacand*), those that are due to be launched in the US (in particular, *Symbicort*) and those that are in development.

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**30 Assets pledged, commitments and contingent liabilities (continued)**

The ongoing monitoring of the projected payments to Merck and the value of the related trading rights to AstraZeneca takes full account of changing business circumstances and the range of possible outcomes to ensure that the payments to be made to Merck are covered by the benefits expected to be realised by the Company. Should the monitoring reveal that these payments exceed the benefits expected to be realised, a provision for an onerous contract will be recognised. The annual contingent payments on agreement products are expensed as incurred.

**Environmental costs and liabilities**

The Group's expenditure on environmental protection, including both capital and revenue items, relates to costs which are necessary for meeting current good practice standards and legal and regulatory requirements for processes and products.

They are an integral part of normal ongoing expenditure for maintaining the Group's R&D and manufacturing capacity and product ranges and are not separated from overall operating and development costs. There are no known changes in legal, regulatory or other requirements resulting in material changes to the levels of expenditure for 2002, 2003 or 2004.

In addition to expenditure for meeting current and foreseen environmental protection requirements, the Group incurs substantial costs in investigating and cleaning up land and groundwater contamination. In particular, AstraZeneca and/or its affiliates have environmental liabilities at some currently or formerly owned, leased and third party sites.

In the US, the AstraZeneca affiliate, Zeneca Inc., and/or its indemnitees, have been named as potentially responsible parties (PRPs) or defendants at approximately 13 sites where Zeneca Inc. is likely to incur future investigation, remediation or operation and maintenance costs under federal or state, statutory or common law environmental liability allocations schemes. Similarly, the AstraZeneca affiliate, Stauffer Management Company LLC (SMC), which was established in 1987 to own and manage certain assets of Stauffer Chemical Company acquired that year, and/or its indemnitees, have been named as PRPs or defendants at approximately 29 sites where SMC is likely to incur future investigation, remediation or operation and maintenance costs under federal or state, statutory or common law environmental liability allocations schemes. In Europe and other parts of the world outside the US, AstraZeneca is likely to incur costs at three currently owned sites and has given indemnities to third parties in respect of approximately 45 other sites. These environmental liabilities arise almost entirely from legacy operations that are not part of our current pharmaceuticals business and, at most of these sites, remediation, where required, is either completed or nearing completion. In the aggregate, however, significant expenditure on clean up and monitoring is likely to be required.

AstraZeneca has made provisions for the estimated costs of future environmental investigation, remediation and operation and maintenance activity beyond normal ongoing expenditure for maintaining the Group's R&D and manufacturing capacity and product ranges where it is probable that such costs will be incurred and can be estimated reliably. With respect to such estimated, future costs, there were provisions at 31 December 2004 in the aggregate of approximately \$96m, of which approximately \$86m relates to the US. These provisions do not include possible, additional costs that are not currently probable, nor do these provisions include costs that, by agreement, will be borne by viable third party indemnitors. In addition, these provisions: (1) include, where appropriate, unasserted claims where future costs are nonetheless probable (at owned sites, for example); (2) are based, where applicable, on liability allocation or cost sharing agreements that we believe are enforceable against viable third parties; (3) reflect expected insurance recoveries where an insurer has agreed to provide an indemnity; and (4) typically cover a time period of five years (with the exception of operation and maintenance activity, which can last for decades). AstraZeneca is not presently aware of any circumstances or uncertainties regarding the viability of liable third parties, indemnitors or insurers that would cause these provisions to be altered.

It is possible that the Company, or its affiliates, could incur future environmental costs beyond the extent of our current provisions. The extent of such possible, additional costs is inherently difficult to estimate due to a number of factors, including, but not limited to: (1) the nature and extent of claims that may be asserted in the future; (2) whether the Company or any of its affiliates has or will have any legal obligation with respect to asserted or unasserted claims; (3) the type of remedial action, if any, that may be selected at sites where the remedy is presently not known; (4) the potential for recoveries from or allocation of liability to third parties; and (5) the length of time that the environmental investigation, remediation and liability allocation process can take. Notwithstanding and subject to the foregoing, it is estimated that potential additional loss, for future environmental investigation, remediation and

operation and maintenance activity above and beyond our provisions, could be, in the aggregate, in the order of \$20m to \$40m.

**Legal proceedings**

AstraZeneca is involved in various legal proceedings considered typical to its businesses, including litigation relating to employment, product liability, commercial disputes, infringement of intellectual property rights and the validity of certain patents. The more significant matters are discussed below.

***Crestor* (rosuvastatin)**

AstraZeneca Pharmaceuticals LP and/or AstraZeneca LP in the US have been served with two individual lawsuits involving alleged injury in association with the use of *Crestor*. In addition, a motion for authorisation to institute a class action and to be a representative was filed in Quebec, Canada against AstraZeneca PLC and AstraZeneca Canada Inc.. The petitioner claims alleged injury as a result of the use of *Crestor*. AstraZeneca is vigorously defending all such claims and lawsuits.

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## Notes to the Financial Statements continued

### 30 Assets pledged, commitments and contingent liabilities (continued)

#### ***Diprivan (propofol)***

In August 2002, AstraZeneca LP received a letter from ESI Lederle, a division of Wyeth, informing AstraZeneca of Wyeth's intention to market a generic version of *Diprivan* prior to the expiration of AstraZeneca's patents covering the current formulation. AstraZeneca filed a patent infringement action against Wyeth in the US District Court for the Southern District of New York. Through a series of transactions, the holder of the relevant Abbreviated New Drug Application (ANDA) and now defendant in AstraZeneca's suit is Mayne Pharma (USA) Inc. (formerly called Faulding Pharmaceutical Co.). Mayne responded to AstraZeneca's complaint and filed counterclaims alleging non-infringement, invalidity and unenforceability. Discovery and claim construction took place during 2004 and the trial is expected to commence in February 2005. AstraZeneca maintains that its patents are valid, enforceable and infringed by Mayne's propofol product. If the court finds that AstraZeneca's patents are valid, enforceable and infringed by Mayne's propofol product, AstraZeneca will seek an injunction preventing the manufacture, use, sale and offering for sale in the US of Mayne's propofol product. Under the ANDA statute, the FDA may not approve Mayne's propofol product before February 2005.

#### ***Exanta (ximelagatran)***

On or about 27 January 2005, a putative class action was filed in the US District Court for the District of Massachusetts on behalf of purchasers of AstraZeneca publicly traded securities during the period 2 April 2003 to 11 October 2004 against AstraZeneca PLC, Percy Barnevik, Håkan Mogren, Sir Tom McKillop and Jonathan Symonds. The lawsuit asserts claims under sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, alleging that the defendants made false and misleading statements regarding *Exanta* clinical trials and the status of the New Drug Application for *Exanta* in the US. AstraZeneca denies the allegations and will vigorously defend the action.

#### ***Iressa (gefitinib)***

In 2004, two claims were filed against AstraZeneca KK in Japan, in the Osaka and Tokyo District Courts respectively. In each claim, it is alleged that *Iressa* caused a fatal incidence of interstitial lung disease (ILD) in a Japanese patient. AstraZeneca KK, following consultation with external legal advisers, believes the claims are without merit and is defending both cases. ILD is a known complication of lung disease, including advanced lung cancer, regardless of treatment.

#### ***Losec/Prilosec (omeprazole)***

In March 2000, the German Federal Patent Court declared that AstraZeneca's formulation patent for omeprazole was invalid. AstraZeneca appealed the decision to the German Supreme Court. As a consequence, all pending infringement actions in Germany were stayed awaiting the outcome of the appeal. At the time, AstraZeneca obtained an interlocutory injunction against ratiopharm GmbH based on the formulation patent. In March 2004, the German Supreme Court heard AstraZeneca's appeal and the court confirmed the decision of the German Federal Patent Court declaring the patent invalid. AstraZeneca has sought leave to appeal this decision to the German Constitutional Court. Following the German Supreme Court decision, ratiopharm GmbH was seeking damages from AstraZeneca for lost sales due to the interlocutory injunction obtained by AstraZeneca against ratiopharm. In January 2005, the matter was settled on terms which do not have a material effect on AstraZeneca's financial position.

In June and July 2004, AstraZeneca applied in France for injunctions based on its omeprazole formulation patent against six companies for marketing generic omeprazole. In August 2004, the applications were rejected at first instance. AstraZeneca has appealed this decision. A hearing on the appeal is scheduled for February 2005. In May 2004, AstraZeneca also started legal proceedings against the same companies for infringement of its omeprazole formulation patent in France. These proceedings have been consolidated with a case challenging the validity of the patent, brought by one of the companies against AstraZeneca. No date has yet been set for a hearing.

In 2001, AstraZeneca filed suit in the US against Andrx Pharmaceuticals, Inc. for infringement of a patent directed to a process for making an omeprazole formulation (the 281 patent). Andrx filed counterclaims of non-infringement, invalidity and unenforceability

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for inequitable conduct during prosecution of the '281 patent. Andrx also asserted that the '281 patent as well as two formulation patents, the '505 and '230 patents, were unenforceable for alleged litigation misconduct by AstraZeneca. Both parties sought attorneys' fees. In May 2004, the US District Court for the Southern District of New York ruled that the '281 patent was infringed, but also ruled that the '281 patent was invalid. The court dismissed Andrx's litigation misconduct and other counterclaims and affirmative defences, leaving intact the court's October 2002 decision finding the '230 and '505 patents not invalid and infringed by Andrx. The October 2002 decision was affirmed in all respects on appeal in December 2003. The court entered final judgement regarding the '281 patent in July 2004, after determining to stay the attorneys' fees claims pending any appeals. Andrx has appealed the judgement and AstraZeneca has cross-appealed.

In April 2001, Andrx filed a case in the US District Court for the Southern District of New York against AstraZeneca, Merck & Co., Inc. and the US Food and Drug Administration, alleging that the listing of certain patents in the FDA's Orange Book was improper and constituted violations of certain provisions of the Sherman Act, the US federal anti-trust legislation, and a state statute analogous to the federal anti-trust laws. Andrx sought injunctive relief compelling the parties to de-list omeprazole-related patents it claimed were improperly listed in the Orange Book and prohibiting the defendants from using patents to delay the effective date of the FDA's approval of Andrx's Abbreviated New Drug Application for omeprazole. AstraZeneca and Merck filed motions to dismiss the case and Andrx filed a motion for summary judgement. The case was stayed by the court in 2001 and then administratively dismissed in 2002.

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**30 Assets pledged, commitments and contingent liabilities (continued)**

During 2000 and 2001, AstraZeneca had filed suits against Lek Pharmaceutical and Chemical Company d.d. and Lek Services USA, Inc., Impax Laboratories Inc., Eon Labs Manufacturing Inc., Mylan Pharmaceuticals Inc., Apotex Corp, Apotex, Inc. and Torpharm, Inc., and Zenith Goldline Pharmaceuticals, Inc. (now known as Ivax Pharmaceuticals, Inc.). These suits followed the filing of Abbreviated New Drug Applications by these companies with the FDA concerning the companies' intention to market generic omeprazole products in the US. The basis for the proceedings is that the actions of all the companies infringe the 505 and 230 formulation patents relating to omeprazole. The cases are proceeding under the US Hatch-Waxman legislation. The case against Ivax was dismissed without prejudice shortly after it was filed, after Ivax withdrew its application to market generic omeprazole. During 2003, after Mylan commenced commercial sale of its product, AstraZeneca filed suit against Laboratorios Esteve, SA and Esteve Quimica, SA, manufacturers of the omeprazole product to be distributed in the US by Mylan. In 2003 and 2004, Lek, Apotex and Impax all began commercial sales of their generic omeprazole products. AstraZeneca has added claims for damages against each of the selling defendants. Anti-trust and non-infringement counterclaims have been filed by Andrx, Apotex/Torpharm, Impax, Eon and Lek. All defendants but Lek have also raised invalidity and unenforceability counterclaims. The anti-trust counterclaims, as well as AstraZeneca's claims for damages, have been stayed pending resolution of the patent liability issues. The cases have been consolidated for discovery before, or are directly assigned to, Judge Jones in the US District Court for the Southern District of New York. All discovery is expected to be completed in February 2005. In July 2004, Lek filed a motion for summary judgement of non-infringement, which is pending. Briefing of any remaining motion for summary judgement is scheduled to be completed by April 2005. No trial date has been set.

During 2000, AstraZeneca was granted interlocutory injunctions based on certain of AstraZeneca's omeprazole patents against the generic company, Scandinavian Pharmaceuticals-Generics AB (Scand Pharm), in Denmark and Norway. In October 2001, Oslo City Court in Norway found that Scand Pharm had infringed AstraZeneca's formulation patent for omeprazole. At the same time, the court declared AstraZeneca's formulation patent valid. In November 2004, these findings were upheld by the Appeal Court. As a result of the Norwegian case, Scand Pharm cannot sell its omeprazole product in Norway. Furthermore, it is also prevented from selling its omeprazole product in Denmark pending the outcome of the main action in the Danish case. If the final decisions in these cases are against AstraZeneca, Scand Pharm may claim damages for lost sales due to the interlocutory injunctions. During 2003 and 2004, AstraZeneca was denied interlocutory injunctions based on certain of its omeprazole patents against Novartis Sverige AB and ratiopharm AB in Sweden and Novartis Finland Oy and ratiopharm Oy in Finland. An interlocutory injunction against Biochemie Novartis Healthcare A/S was granted in Denmark during 2003, based on AstraZeneca's omeprazole formulation patent. Also during 2003, the District Court in Norway found that the generic omeprazole product marketed by ratiopharm AS did not infringe AstraZeneca's omeprazole formulation patent. In December 2004, an interlocutory injunction against Nomeco A/S, a Danish distributor of a generic omeprazole product from ratiopharm, was granted in Denmark based on AstraZeneca's omeprazole formulation patent.

AstraZeneca has been and continues to be involved in numerous proceedings in Canada involving Genpharm, Reddy Cheminor, Rhoxalpharma and Apotex. These cases relate to omeprazole capsules or omeprazole magnesium tablets and involve various patents. AstraZeneca could potentially be liable for damages in some cases. However, there are no financial claims currently being made against AstraZeneca in Canada in any litigation in respect of omeprazole capsules or omeprazole magnesium tablets. Apotex launched a generic omeprazole capsule product in Canada in January 2004. Following this launch, AstraZeneca commenced judicial review proceedings seeking to quash Apotex's Notice of Compliance (marketing approval). In September 2004, the case was decided against AstraZeneca. AstraZeneca's appeal of the September 2004 decision is scheduled for February 2005. AstraZeneca sued Apotex in July 2004 alleging infringement of its formulation patents by Apotex's omeprazole capsules.

In February 2000, the European Commission commenced an investigation relating to certain omeprazole intellectual property rights, and associated regulatory and patent infringement litigation. The investigation is pursuant to Article 82 of the EC Treaty, which prohibits an abuse of a dominant position. The investigation was precipitated by a complaint by a party to a number of patent and other proceedings involving AstraZeneca. AstraZeneca has, in accordance with its corporate policy, co-operated with the Commission. In July 2003, the Commission served a Statement of Objections on AstraZeneca, referring to alleged infringements regarding the obtaining of supplementary protection certificates for omeprazole in certain European countries; and regarding

AstraZeneca's replacement of omeprazole capsules by omeprazole MUPS (tablets) and withdrawal of capsule marketing authorisations in three European countries. AstraZeneca replied fully to the Commission, explaining why its actions were in AstraZeneca's view lawful. An oral hearing took place in February 2004. If, ultimately, (and subject to any appeals to the Court of First Instance and the European Court of Justice) it is held that Article 82 has been infringed, then there may be a liability to fines and/or other measures which can be imposed by the Commission. There could also be liability for alleged losses incurred by aggrieved third parties. It is not possible, at the present time, to quantify any such liabilities as no Decision has been issued by the Commission, no fines have to date been imposed and no claims for damages have been received. Moreover, bearing in mind the timescales of proceedings, including appeals, there may well be a considerable period before any such liabilities are finally established (even if, which is denied, any such liabilities exist).

**Nexium (esomeprazole)**

AstraZeneca entities have been sued in state courts in the US in purported representative and class actions involving the marketing of *Nexium* (esomeprazole). These actions generally allege that AstraZeneca's promotion and advertising of *Nexium* to physicians and consumers is unfair, unlawful and deceptive conduct, particularly as the promotion relates to comparisons of *Nexium* with *Prilosec*. They also allege that AstraZeneca's conduct relating to the pricing of *Nexium* was unfair, unlawful and deceptive. The plaintiffs allege claims under various state consumer protection, unfair practices and false advertising laws. The plaintiffs in these cases seek remedies that include restitution, disgorgement of profits, damages, punitive damages, injunctive relief, attorneys' fees and costs of suit.

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## Notes to the Financial Statements continued

### 30 Assets pledged, commitments and contingent liabilities (continued)

In October 2004, the first action was brought in the Superior Court of the State of California for the County of Los Angeles by the AFL-CIO, two unincorporated associations and an individual on behalf of themselves, the general public and a class of California consumers, third party payers, cash payers and those making co-pay. A second action has been filed in the same court on behalf of a similar putative class of consumers. Actions making similar allegations were filed on behalf of a putative class of consumers in the Circuit Court of Searcy County, Arkansas and on behalf of a putative class of third party payers in the Superior Court of the State of Delaware in and for New Castle County.

In addition, in December 2004, AstraZeneca received a pre-litigation demand from claimants in Massachusetts who allege similar claims under Massachusetts law on behalf of themselves and a proposed class of purchasers of *Nexium* in Massachusetts.

AstraZeneca denies the allegations and is vigorously defending each of these actions.

In October 2004, AstraZeneca LP filed suit in the US District Court for the District of Delaware seeking declaratory judgement that its *Better is Better* campaign for *Nexium* is not false or misleading advertising in violation of section 43(a) of the Lanham Act, a federal statute governing false advertising claims. The action was taken in response to a letter from TAP Pharmaceuticals, Inc. demanding that AstraZeneca immediately withdraw the television commercial and other components of the direct-to-consumer advertising campaign for *Nexium* on the basis that they allegedly constitute violations of the statute. In November 2004, TAP requested expedited consideration of the case by filing a motion for a preliminary injunction. In December 2004, the court held a hearing on this motion and denied the request for a preliminary injunction. A trial date has been scheduled for April 2006.

#### ***Nolvadex (tamoxifen)***

AstraZeneca is a co-defendant with Barr Laboratories, Inc. in numerous purported class actions filed in federal and state courts throughout the US. All of the state court actions were removed to federal court and have been consolidated, along with all of the cases originally filed in federal court, in a federal multi-district litigation proceeding pending in the US District Court for the Eastern District of New York. Some of the cases were filed by plaintiffs representing a putative class of consumers who purchased tamoxifen. The other cases were filed on behalf of a putative class of third party payers (including health maintenance organisations, insurers and other managed care providers and health plans) that have reimbursed or otherwise paid for prescriptions of tamoxifen. The plaintiffs allege that they paid supra-competitive and monopolistic prices for tamoxifen as a result of the settlement of patent litigation between Zeneca and Barr in 1993. The plaintiffs seek injunctive relief, treble damages under the anti-trust laws, disgorgement and restitution. In April 2002, AstraZeneca filed a motion to dismiss the cases for failure to state a cause of action. In May 2003, the US District Court for the Eastern District of New York granted AstraZeneca's motion to dismiss. The plaintiffs appealed the decision. Oral arguments in the appeal were heard by the United States Court of Appeals for the Second Circuit in July 2004. The court's decision is awaited.

#### ***Plendil (felodipine)***

In August 2000, AstraZeneca LP received a letter from Mutual Pharmaceutical Co., Inc. informing AstraZeneca of Mutual's intention to market a generic version of AstraZeneca's *Plendil* extended release tablets prior to the expiration of AstraZeneca's patent covering the extended release formulation. AstraZeneca filed a patent infringement action against Mutual in the US District Court for the Eastern District of Pennsylvania. Mutual responded and filed counterclaims alleging non-infringement and invalidity. In March 2003, the District Court granted summary

judgement in favour of AstraZeneca as to the infringement claim, holding that Mutual infringed AstraZeneca's formulation patent. In August 2003, the District Court granted summary judgement in favour of AstraZeneca as to the validity claim, holding that AstraZeneca's patent is valid. Mutual then filed a notice of appeal as to both of these decisions to the US District Court of Appeals for the Federal Circuit.

In September 2004, the Federal Circuit Court reversed the ruling by the District Court as to infringement and held that Mutual's extended release felodipine tablets, as a matter of law, do not infringe AstraZeneca's formulation patent. However, the Federal Circuit Court upheld the District Court's decision as to validity, ruling that AstraZeneca's formulation patent is valid as a matter of law.

In April 2004, Zenith Goldline Pharmaceuticals, Inc. (now known as Ivax Pharmaceuticals, Inc.) filed a motion for summary judgement on the issue of non-infringement in the patent infringement action pending between AstraZeneca Pharmaceuticals LP and Zenith/Ivax in the US District Court for the District of New Jersey. The patent infringement action against Zenith/Ivax, which AstraZeneca filed in July 2001, resulted from a May 2001 letter to AstraZeneca in which Zenith/Ivax declared its intention to market a generic version of *Plendil* extended release tablets prior to the expiration of AstraZeneca's patent covering the extended release formulation. Zenith/Ivax filed counterclaims in the litigation alleging non-infringement. In August 2004, the District Court issued an order dismissing this action, without prejudice, pending the consummation of a settlement of the matter and granting the parties the right, upon motion and good cause shown, to re-open the legal action if the settlement were not consummated within 60 days of the date of the order. The parties jointly proposed to the District Court that the 60 day period be extended by 30 days. In November 2004, the District Court entered an order of dismissal reflecting the parties' agreement that AstraZeneca dismiss its claim of infringement and Ivax dismiss its counterclaim of invalidity.

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**30 Assets pledged, commitments and contingent liabilities (continued)*****Seroquel* (quetiapine fumarate)**

AstraZeneca PLC and AstraZeneca Pharmaceuticals LP have been named as defendants in the case of Susan Zehel-Miller et al. v. AstraZeneca [sic], AstraZeneca Pharmaceuticals, LP [sic], a putative class action suit filed in August 2003 in the US District Court for the Middle District of Florida. The named plaintiffs are seeking damages and injunctive relief on behalf of a purported class consisting of all persons in the United States who purchased and/or used *Seroquel*. Although the scope of the allegations in the complaint is very broad, the primary focus appears to be the contention that AstraZeneca failed to provide adequate warnings in connection with an alleged association between *Seroquel* and the onset of diabetes. In August 2004, the court denied class certification in this matter. The plaintiffs' motion to the Court of Appeals for leave to pursue an interlocutory appeal of the decision was denied in January 2005. AstraZeneca is vigorously defending the claims of the two remaining plaintiffs in this matter.

***Symbicort* (budesonide/formoterol)**

In February 2004, Ivax Pharmaceuticals (UK) Limited initiated proceedings against AstraZeneca AB claiming that the UK parts of two European patents related to *Symbicort* were invalid. In May 2004, the court granted AstraZeneca's application for a stay of the proceedings pending the determination of parallel opposition proceedings before the European Patent Office. In April 2004, Ivax initiated proceedings against AstraZeneca AB in relation to the Republic of Ireland claiming that two European patents related to *Symbicort* were invalid. In October 2004, the court granted AstraZeneca's application for a stay of proceedings pending the final decision of the European Patent Office and its Boards of Appeal in the opposition proceedings.

***Toprol-XL* (metoprolol succinate)**

In May 2003, AstraZeneca filed a patent infringement action against KV Pharmaceutical Company in the US District Court for the Eastern District of Missouri in response to KV's notification of its intention to market a generic version of *Toprol-XL* tablets in the 200mg dose prior to the expiration of AstraZeneca's patents covering the substance and its formulation. In response to later similar notices from KV related to the 100mg and 50mg doses, AstraZeneca filed further actions. KV responded in each instance and filed counterclaims alleging non-infringement, invalidity and unenforceability of the listed patents.

In February 2004, AstraZeneca filed a patent infringement action against Andrx Pharmaceuticals LLC in the US District Court for the District of Delaware in response to Andrx's notification of its intention to market a generic version of *Toprol-XL* tablets in the 50mg dose prior to the expiration of AstraZeneca's patents. In response to two later similar notices from Andrx related to the 25mg, 100mg and 200mg doses, AstraZeneca filed two additional patent infringement actions in the same court. In each instance, Andrx claims that each of the listed patents is invalid, not infringed and unenforceable.

In April 2004, AstraZeneca filed a patent infringement action against Eon Labs Manufacturing Inc. in the US District Court for the District of Delaware in response to Eon's notification of its intention to market generic versions of *Toprol-XL* tablets in the 25mg, 50mg, 100mg and 200mg doses prior to the expiration of AstraZeneca's patents. In its response, Eon alleged that each of the listed patents is invalid, not infringed and unenforceable.

All of the patent litigation relating to *Toprol-XL* against KV, Andrx and Eon has been consolidated for pre-trial discovery purposes and motion practice in the US District Court for the Eastern District of Missouri. The defendants filed a motion for summary judgement in December 2004 alleging that the *Toprol-XL* patents are invalid due to double patenting. Briefing is ongoing. In January 2005 AstraZeneca filed a terminal disclaimer of the *Toprol-XL* patents-in-suit over one of the other patents raised by the defendants, which will result in a revision of the expiration date of the *Toprol-XL* patents-in-suit from March 2008 to September 2007. Discovery and motion practice are expected to be active through at least the first half of 2005. No trial date has been set in the consolidated proceedings. Under the Abbreviated New Drug Application statute, the FDA may not approve KV's product before September 2005, Andrx's product before June 2006 or Eon's product before August 2006, unless there is an earlier adverse court decision.

AstraZeneca maintains that its patents are valid, enforceable and infringed by these KV, Andrx and Eon products.

**Zestril (lisinopril)**

In 1996, two of AstraZeneca's predecessor companies, Zeneca Limited and Zeneca Pharma Inc. (as licensees), and Merck & Co., Inc. and Merck Frosst Canada Inc. commenced a patent infringement action in the Federal Court of Canada against Apotex Inc., alleging infringement of Merck's lisinopril patent. Apotex has sold and continues to sell a generic version of AstraZeneca's *Zestril* and Merck's Prinivil tablets. Apotex has admitted infringement but has raised positive defences to infringement, including that it acquired certain quantities of lisinopril prior to issuance of the patent and that certain quantities were licensed under a compulsory licence. Apotex has also alleged invalidity of the patent. The trial is scheduled for January 2006.

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## Notes to the Financial Statements continued

### 30 Assets pledged, commitments and contingent liabilities (continued)

#### Average wholesale price class action litigation

In January 2002, AstraZeneca was named as a defendant along with 24 other pharmaceutical manufacturers in a class action suit, in Massachusetts, brought on behalf of a putative class of plaintiffs alleged to have overpaid for prescription drugs as a result of inflated wholesale list prices. The suit seeks to recover unspecified damages. AstraZeneca has also been named as a co-defendant with various other pharmaceutical manufacturers in similar suits filed in nine other states. Most of these suits have been consolidated with the Massachusetts action for pre-trial purposes pursuant to federal multi-district litigation procedures. The court has issued a scheduling order setting out a briefing schedule for class certification and summary judgement motions. That order groups five of the pharmaceutical manufacturer co-defendants, including AstraZeneca, into a group called the Fast Track defendants. The court has scheduled a hearing on the plaintiffs motion for class certification relating to the Fast Track defendants for February 2005. A hearing on the Fast Track motions for summary judgement is scheduled for June 2005. In addition to the consolidated proceedings in Massachusetts, additional suits are proceeding independently in four states. These include separate suits brought by the Commonwealth of Pennsylvania, the Commonwealth of Kentucky and the State of Wisconsin to recover alleged damages on behalf of those states and their residents, as well as a class action brought by an individual plaintiff in Arizona on behalf of individuals and entities in that state. AstraZeneca believes that it has meritorious defences to all of these claims.

#### Retail pharmacies /drug purchasers actions

Since October 1993, several thousand retail pharmacies and certain retail drug purchasers have commenced purported class actions and individual actions in various federal and state courts throughout the US alleging that, with respect to brand name prescription drugs, manufacturers and wholesalers engaged in discriminatory pricing practices and/or discriminatory discounting and rebate practices, and/or conspired with one another to fix prices and artificially maintain high prices to the plaintiffs in restraint of trade and commerce. More than 20 brand name prescription drug manufacturers and eight wholesalers have been named defendants in some or all of these suits.

In November 2004, AstraZeneca settled the single remaining retail case pending against it in the Northern District of Illinois. Consequently, all of these cases against AstraZeneca have now been settled or dismissed.

#### Additional government investigations into drug marketing practices

As is true for most, if not all, major prescription pharmaceutical companies operating in the US, AstraZeneca is currently involved in multiple additional US federal and state criminal and civil investigations into drug marketing and pricing practices. Five of these investigations are being handled by the US Attorney's Office in Boston. One involves a request for production of documents relating to the sale and promotion of *Prilosec* to the New England Medical Center in Boston. A second subpoena from the same office requests documents relating to the sale and marketing of products to an individual physician in Worcester, Massachusetts and certain physicians and entities affiliated with that physician. A third subpoena from that office seeks documents relating to speaker programmes involving healthcare professionals at three regional healthcare entities in the Boston area. A fourth subpoena requests documents relating to interactions with physicians at a large, regional clinic and affiliated entities in north eastern Massachusetts. The fifth subpoena from the Boston US Attorney's Office relates to the marketing and sale of three products (*Zestril*, *Naropin* and *Cefotan*) to a leading provider of pharmacy services to long term care facilities.

AstraZeneca has received a subpoena from the Massachusetts Attorney General's Office seeking documents relating to the sale and promotion of five products (*Prilosec*, *Seroquel*, *Rhinocort Aqua*, *Toprol-XL* and *Zestril*) within Massachusetts. In October 2004, AstraZeneca received a subpoena from the US Attorney's Office in Philadelphia principally seeking documents relating to the formulary status of AstraZeneca drugs at a regional health maintenance organisation and a national pharmacy benefits manager. Most recently, AstraZeneca, along with 12 other pharmaceutical manufacturers, was served with a subpoena from the US Attorney's Office in Philadelphia seeking documents in connection with the government's pending civil litigation against Medco Health Systems. That subpoena seeks documents relating to contracts, programmes, grants or payments to Medco.

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AstraZeneca is co-operating fully with all of these investigations. It is not possible to predict the outcome of any of these investigations, which could include the payment of damages and the imposition of fines, penalties and administrative remedies.

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**30 Assets pledged, commitments and  
contingent liabilities (continued)****Drug importation anti-trust litigation**

In May 2004, plaintiffs in a purported class action filed complaints in the US District Court for Minnesota and for New Jersey, alleging that AstraZeneca Pharmaceuticals LP and eight other pharmaceutical manufacturer defendants conspired to prevent American consumers from purchasing prescription drugs from Canada, depriving consumers of the ability to purchase drugs at competitive prices. The New Jersey case was voluntarily dismissed in July 2004 and only the Minnesota proceedings remain pending. The plaintiffs seek injunctive relief, restitution and other remedies. The defendants in the Minnesota action filed a motion to dismiss the case for failure to state a cause of action. Oral argument on the motion to dismiss was heard in January 2005. A decision on the motion is awaited.

In August 2004, Californian retail pharmacy plaintiffs filed an action in the Superior Court of California making similar allegations. As in the Minnesota action, the defendants in this action have moved to dismiss the case for failure to state a cause of action. It is expected that oral argument on the motion will be held in early 2005.

AstraZeneca denies the material allegations of both the Minnesota and California actions and is vigorously defending these matters.

**StarLink**

AstraZeneca Insurance Company Limited (AZIC) has commenced arbitration proceedings in the UK against insurers in respect of amounts paid by Garst Seed Company of the US in settlement of claims arising in the US from Garst's sale of StarLink, a genetically engineered corn seed. AstraZeneca's interest in Garst was through AstraZeneca's 50% ownership of Advanta BV, the sale of which to Syngenta was announced in May 2004 and completed in September 2004. AZIC's claim against the insurers will not be affected by the disposal of AstraZeneca's interest in Advanta BV.

**Salick Health Care, Inc.**

In April 2004, Comprehensive Cancer Centers, Inc. (CCC), a subsidiary of Salick Health Care, Inc. received a subpoena from the US Department of Justice seeking, among other items, medical records and related documentation for services provided to patients at the Comprehensive Cancer Center at Desert Regional Medical Center in Palm Springs, California. The Center is managed by CCC, which is co-operating fully with the document request.

**Taxation**

Where tax exposures can be quantified, a provision is made based on best estimates and management's judgement. Details of the material tax exposures are as follows:

AstraZeneca has made certain double taxation relief claims in accordance with its understanding of existing law. We understand that other taxpayers have recently been denied credit for foreign taxes in similar claims. The estimated tax exposure provided for in respect of the issue is \$197m, although the potential additional losses above and beyond the amount provided is estimated to be up \$130m; however, management believes that it is unlikely that these additional losses will arise. AstraZeneca expects a definitive ruling or clarification of law on the availability of credit for foreign taxes in the next 12 months. Until these cases are resolved either in court or through clarification of existing law, there is some risk that credits may not be allowed, giving rise to effective double taxation. In this event, the Company will seek relief under the relevant double tax treaty.

AstraZeneca faces a number of transfer pricing audits in jurisdictions around the world. The issues under audit are often complex and can require many years to resolve. Accruals for tax contingencies require management to make estimates and judgements with respect to the ultimate outcome of a tax

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audit, and actual results could vary from these estimates. The total accrual included in the Financial Statements to cover the worldwide exposure to transfer pricing audits is \$400m. It is not possible to estimate any additional exposure that may arise or the timing of tax cash flows in relation to each outcome.

Included in the provision is an amount of interest of \$107m. Interest is accrued as a tax expense.

Of the remaining tax exposures, the Company does not expect material additional losses.

### **General**

With respect to each of the legal proceedings described above, other than those which have been disposed of, we are unable to make estimates of the loss or range of losses at this stage. We also do not believe that disclosure of the amount sought by plaintiffs, if that is known, would be meaningful with respect to those legal proceedings. This is due to a number of factors including, for example, the stage of the proceedings (in many cases trial dates have not been set) and overall length and extent of legal discovery; the entitlement of the parties to an action to appeal a decision; clarity as to theories of liability; damages and governing law; uncertainties in timing of litigation; and the possible need for further legal proceedings to establish the appropriate amount of damages, if any. However, although there can be no assurance regarding the outcome of any of the legal proceedings or investigations referred to in this Note 30 to the Financial Statements, we do not expect them to have a materially adverse effect on our financial position or profitability.

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## Notes to the Financial Statements continued

**31 Leases**

Total rentals under operating leases charged to profit and loss account were as follows:

	2004 \$m	2003 \$m	2002 \$m
Hire of plant and machinery	50	21	23
Other	77	73	96
	<b>127</b>	94	119

Commitments under operating leases to pay rentals during the year following the year of these Financial Statements analysed according to the period in which each lease expires were as follows:

	Land and buildings		Other assets	
	2004 \$m	2003 \$m	2004 \$m	2003 \$m
Expiring within one year	7	9	12	13
Expiring in years two to five	25	23	31	26
Expiring thereafter	35	38	2	3
	<b>67</b>	70	<b>45</b>	42

The future minimum lease payments under operating leases that have initial or remaining terms in excess of one year at 31 December 2004 were as follows:

	Operating leases	
	2004 \$m	2003 \$m
<b>Obligations under leases comprise</b>		
Rentals due within one year	112	112
Rentals due after more than one year:		
After five years from balance sheet date	69	80

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From four to five years	<b>28</b>	25
<hr/>		
From three to four years	<b>35</b>	28
<hr/>		
From two to three years	<b>45</b>	40
<hr/>		
From one to two years	<b>63</b>	56
<hr/>		
	<b>240</b>	229
<hr/>		
	<b>352</b>	341
<hr/>		

The Group had no commitments (2003 \$nil) under finance leases at the balance sheet date which were due to commence thereafter.

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[Back to Contents](#)**32 Statutory and other information**

	2004 \$m	2003 \$m	2002 \$m
<b>Audit fees KPMG Audit Plc and its associates</b>			
Audit services	8.4	5.4	3.5
Further assurance services	1.4	2.1	1.5
Taxation services	2.0	1.8	1.8
Other services			0.2
	<b>11.8</b>	9.3	7.0
<b>Audit fees others</b>			
			0.1
	<b>11.8</b>	9.3	7.1

Audit services include fees in respect of the Group audit, the audit of the Group's preliminary financial statements under International Financial Reporting Standards, work in relation to Sarbanes-Oxley s404, and fees for other services required by statute or regulation. The fee for the audit of the parent company is \$1,600 (2003 \$1,600, 2002 \$1,600). Fees for further assurance services include employee pension fund and other benefit plan audit services together with control reviews associated with new systems implementations. Taxation services consist of tax compliance services and tax advice.

\$0.9m (2003 \$0.5m, 2002 \$0.4m) of the total fees for further assurance, taxation and other services were charged in the UK.

**Related party transactions**

The Group had no material related party transactions which might reasonably be expected to influence decisions made by the users of these Financial Statements.

**Subsequent events**

No significant change has occurred since the date of the annual Financial Statements.

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**Notes to the Financial Statements** continued**33 Company information****Company Balance Sheet**

At 31 December	Notes	2004 \$m	2003 \$m
<b>Fixed assets</b>			
Fixed asset investments	33	7,745	6,940
<b>Current assets</b>			
Debtors other		25	7
Debtors amounts owed by subsidiaries		23,228	25,339
		23,253	25,346
<b>Total assets</b>		<b>30,998</b>	<b>32,286</b>
<b>Creditors due within one year</b>			
Non-trade creditors	33	(3,590)	(3,120)
Net current assets		19,663	22,226
Total assets less current liabilities		27,408	29,166
<b>Creditors due after more than one year</b>			
Loans owed to subsidiaries	33	(283)	(295)
Loans external	33	(747)	
		(1,030)	(295)
<b>Net assets</b>		<b>26,378</b>	<b>28,871</b>
<b>Capital and reserves</b>			
Called-up share capital	34	411	423
Share premium account	33	550	449

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Capital redemption reserve	33	<b>36</b>	23
<hr/>			
Other reserves	33	<b>1,841</b>	1,841
<hr/>			
Profit and loss account	33	<b>23,540</b>	26,135
<hr/>			
<b>Shareholders funds equity interests</b>		<b>26,378</b>	28,871
<hr/>			

The Financial Statements on pages 72 to 135 were approved by the Board of Directors on 27 January 2005 and were signed on its behalf by:

Sir Tom McKillop  
**Director**

Jonathan Symonds  
**Director**

[Back to Contents](#)**33 Company information (continued)****Deferred taxation**

The parent company had deferred tax assets of \$25m at 31 December 2004.

<b>Fixed asset investments</b>	Investments in subsidiaries		
	Shares \$m	Loans \$m	Total \$m
Cost at beginning of year	6,645	295	6,940
Additions	70	747	817
Disposals and other movements		(12)	(12)
<b>Net book value at 31 December 2004</b>	<b>6,715</b>	<b>1,030</b>	<b>7,745</b>
Net book value at 31 December 2003	6,645	295	6,940
<b>Non-trade creditors</b>		<b>2004</b>	2003
		<b>\$m</b>	<b>\$m</b>
Amounts due within one year			
Short term borrowings (unsecured)		4	3
Other creditors		116	154
Amounts owed to subsidiaries		2,409	2,049
Dividends to shareholders		1,061	914
		<b>3,590</b>	3,120
<b>Loans owed to subsidiaries</b>	Repayment Dates	<b>2004</b>	2003
		<b>\$m</b>	<b>\$m</b>

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Loans (unsecured)			
US dollars			
7.2% loan	2023	<b>283</b>	295

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**Loans external**

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5.4% Callable bond	2014	<b>747</b>	
Total loans		<b>1,030</b>	295

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Loans or instalments thereof are repayable:

After five years from balance sheet date		<b>1,030</b>	295
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From two to five years

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From one to two years

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Total unsecured		<b>1,030</b>	295
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Total due within one year

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Total loans		<b>1,030</b>	295
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## Notes to the Financial Statements continued

## 33 Company information (continued)

<b>Reserves</b>	Share premium account \$m	Capital redemption reserve \$m	Other reserves \$m	Profit and loss account \$m	<b>2004 Total \$m</b>	2003 Total \$m
At beginning of year	449	23	1,841	26,135	<b>28,448</b>	30,655
Net gains for the year				1,172	<b>1,172</b>	244
Dividends				(1,555)	<b>(1,555)</b>	(1,350)
Share re-purchases		13		(2,212)	<b>(2,199)</b>	(1,147)
Share premiums	101				<b>101</b>	46
At end of year	550	36	1,841	23,540	<b>25,967</b>	28,448
Distributable reserves at end of year			591	617	<b>1,208</b>	1,592

As permitted by section 230 of the Companies Act 1985, the Company has not presented its profit and loss account.

At 31 December 2004 \$22,923m (31 December 2003 \$25,032m) of the profit and loss account reserve was not available for distribution. The majority of this non-distributable amount relates to profit arising on the sale of Astra AB to a subsidiary in 1999, which becomes distributable as the underlying receivable is settled. During 2004, \$2,109m of the profit was realised by repayment. Subsequent to the year end, a further \$1,625m was repaid on 25 January 2005, resulting in additional distributable reserves not included in the figures above. Included in other reserves is a special reserve of \$157m, arising on the redenomination of share capital in 1999.

<b>Reconciliation of movement in shareholders funds</b>	<b>2004 \$m</b>	2003 \$m
Shareholders funds at beginning of year	<b>28,871</b>	31,084
Net gains for the financial year	<b>1,172</b>	244
Dividends	<b>(1,555)</b>	(1,350)
Issues of AstraZeneca PLC Ordinary Shares	<b>102</b>	47
Re-purchase of AstraZeneca PLC Ordinary Shares	<b>(2,212)</b>	(1,154)
Net reduction in shareholders funds	<b>(2,493)</b>	(2,213)
<b>Shareholders funds at end of year</b>	<b>26,378</b>	28,871



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**34 Called-up share capital of parent company**

	Authorised	Allotted, called-up and fully paid	
	2004 \$m	2004 \$m	2003 \$m
Ordinary Shares (\$0.25 each)	411	411	423
Unissued Ordinary Shares (\$0.25 each)	189		
Redeemable Preference Shares (£1 each £50,000)			
	<b>600</b>	<b>411</b>	423

The Redeemable Preference Shares carry limited class voting rights and no dividend rights. This class of shares is capable of redemption at par at the option of the Company on the giving of seven days' written notice to the registered holder of the shares.

The movements in share capital during the year can be summarised as follows:

	No. of shares (million)	\$m
At beginning of year	1,693	423
Issues of shares	2	1
Re-purchase of shares	(50)	(13)
<b>At 31 December 2004</b>	<b>1,645</b>	<b>411</b>

**Share re-purchase**

During the year the Company re-purchased, and subsequently cancelled, 50,100,000 Ordinary Shares at an average price of 2376 pence per share. The total consideration, including expenses, was \$2,212m. The excess of the consideration over the nominal value has been charged against the profit and loss account reserve.

**Share schemes**

A total of 2,456,945 Ordinary Shares were issued during the year in respect of share schemes. Details of movements in the number of Ordinary Shares under option are shown in Note 29; details of options granted to Directors are shown in the Directors Remuneration Report.

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## Principal Subsidiaries

At 31 December 2004	Country	share capital held	Percentage of voting capital held	Principal activity
<b>UK</b>				
AstraZeneca UK Limited	England	100#		Research and development, production, marketing
AstraZeneca Insurance Company Limited	England	100		Insurance and reinsurance underwriting
AstraZeneca Treasury Limited	England	100		Treasury
<b>Continental Europe</b>				
NV AstraZeneca SA	Belgium	100		Production, marketing
AstraZeneca Dunkerque Production SCS	France	100		Production
AstraZeneca SAS	France	100		Research, production, marketing
AstraZeneca GmbH	Germany	100		Development, production, marketing
AstraZeneca Holding GmbH	Germany	100		Production, marketing
AstraZeneca SpA	Italy	100		Production, marketing
AstraZeneca Farmaceutica Spain SA	Spain	100		Production, marketing
AstraZeneca AB	Sweden	100		Research and development, production, marketing
AstraZeneca BV	The Netherlands	100		Marketing
<b>The Americas</b>				
AstraZeneca Canada Inc.	Canada	100		Research, production, marketing
IPR Pharmaceuticals Inc.	Puerto Rico	100		Development, production, marketing
AstraZeneca LP	US	99		Research and development, production, marketing
AstraZeneca Pharmaceuticals LP	US	100		Research and development,

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			production, marketing
Zeneca Holdings Inc.	US	100	Production, marketing
<b>Asia, Africa &amp; Australasia</b>			
AstraZeneca Pty Limited	Australia	100	Development, production, marketing
AstraZeneca KK	Japan	80	Production, marketing

# Shares held directly

The companies and other entities listed above are those whose results or financial position principally affected the figures shown in the Group's annual Financial Statements. A full list of subsidiaries, joint ventures and associates will be annexed to the Company's next annual return filed with the Registrar of Companies. The country of registration or incorporation is stated alongside each company. The accounting dates of subsidiaries and associates are 31 December, except for Salick Health Care, Inc. which, owing to local conditions and to avoid undue delay in the preparation of the Financial Statements, is 30 November. AstraZeneca operates through 234 subsidiaries worldwide. The Group Financial Statements consolidate the Financial Statements of AstraZeneca PLC and its subsidiaries at 31 December 2004. Products are manufactured in some 20 countries worldwide and are sold in over 100 countries.

## Additional Information for US Investors

### Introduction

The accompanying consolidated Financial Statements included in this Annual Report are prepared in accordance with UK GAAP. There are certain significant differences between UK GAAP and US GAAP which affect AstraZeneca's net income and shareholders' equity and, on pages 125 to 135, additional information under US GAAP is set out as follows:

- > summary of differences between UK and US GAAP accounting principles; page 125
- > net income; page 128
- > US GAAP condensed consolidated statement of operations; page 129
- > US GAAP statement of comprehensive income; page 129
- > stock-based compensation; page 130
- > pension and post-retirement benefits; page 131
- > taxation; page 133
- > shareholders' equity; page 134
- > acquired intangible assets and goodwill; page 134
- > US GAAP condensed consolidated statement of cash flows; page 135

### Differences between UK and US accounting principles

recorded as goodwill. The amount allocated to in-process research and development was, as required by US GAAP, expensed immediately in the first reporting period after the business combination. Fair value adjustments to the recorded amount of inventory were expensed in the period the inventory was utilised. Additional amortisation and depreciation have also been recorded in respect of the fair value adjustments to tangible and intangible assets.

In the consolidated Financial Statements prepared under UK GAAP, goodwill arising on acquisitions made prior to 1 January 1998 accounted for under the purchase method has been eliminated against shareholders' equity. Under the requirements of UK Financial Reporting Standard 10 Goodwill and Intangible Assets, goodwill on acquisitions made after 1 January 1998 is capitalised and amortised over its estimated useful life which is generally presumed not to exceed 20 years. UK GAAP requires that on subsequent disposal or termination of a previously acquired business, any goodwill previously taken directly to shareholders' equity is then charged in the income statement against the profit or loss on disposal or termination. Up until 1 January 2002, under US GAAP, goodwill was required to be capitalised and amortised. Now, instead of being amortised, goodwill is tested annually for impairment.

Identifiable intangible assets, which principally include patents, know-how and product registrations, are amortised over their estimated useful lives which vary between five years and 20 years with a weighted average life of approximately 13 years.

On disposal of a business, the gain or loss under US GAAP may differ from that under UK GAAP due principally to goodwill capitalised and amortised, together with the appropriate share of other differences between UK and US accounting principles recognised previously.

### Capitalisation of interest

AstraZeneca does not capitalise interest in its UK GAAP Financial Statements. US GAAP requires interest incurred as part of the cost of constructing fixed assets to be capitalised and amortised over the life of the asset.

### Dividends

Under UK GAAP, Ordinary Share dividends proposed are provided for in the year in respect of which they are recommended by the Board of Directors for approval by the shareholders. Under US GAAP, such dividends are not provided for until declared by the Board.

### Deferred taxation

Deferred taxation is provided on a full liability basis under US GAAP, which permits deferred tax assets to be recognised if their realisation is considered to be more likely than not. Under current UK GAAP, full provision is also made although there are a number of different bases on which this calculation is made, for example rolled over capital gains.

### Pension and post-retirement benefits

There are four main differences between current UK GAAP and US GAAP in accounting for pension costs:

- (i) US GAAP requires measurements of plan assets and obligations to be made as at the date of the financial statements or a date not more than

**Purchase accounting adjustments**

Under UK GAAP, the merger of Astra and Zeneca was accounted for as a merger of equals (pooling-of-interests). Under US GAAP the merger was accounted for as the acquisition of Astra by Zeneca using purchase accounting. Under purchase accounting, the cost of the investment is calculated at the market value of the shares issued together with other incidental costs and the assets and liabilities of the acquired entity are recorded at fair value. As a result of the fair value exercise, increases in the values of Astra's tangible fixed assets and inventory were recognised and values attributed to its in-process research and development and existing products, together with appropriate deferred taxation effects. The difference between the cost of investment and the fair value of the assets and liabilities of Astra was

At 31 December 2004 and 2003 under US GAAP, shareholders' equity includes capitalised goodwill of \$16,143m and \$15,306m respectively (net of amortisation and impairment of \$2,698m and \$2,596m) and capitalised identifiable intangible assets of \$8,854m and \$9,536m respectively (net of amortisation and impairment of \$8,514m and \$6,739m). Goodwill on businesses disposed of is charged to the gain or loss on disposal.

three months prior to that date. Under UK GAAP, calculations may be based on the results of the latest actuarial valuation;

- (ii) US GAAP mandates a particular actuarial method – the projected unit credit method – and requires that each significant assumption necessary to determine annual pension costs reflects best estimates solely with regard to that individual assumption. UK GAAP does not mandate a particular method, but requires that the method and assumptions taken as a whole should be compatible and lead to the actuary's best estimate of the cost of providing the benefits promised;

## Additional Information for US Investors continued

### Differences between UK and US accounting principles (continued)

(iii) under US GAAP, a negative pension cost may arise where a significant unrecognised net asset or gain exists at the time of implementation. This is required to be amortised on a straight-line basis over the average remaining service period of employees. Under UK GAAP, AstraZeneca's policy is not to recognise pension credits in its Financial Statements unless a refund of, or reduction in, contributions is likely; and

(iv) under US GAAP, a minimum pension liability is recognised through other comprehensive income in certain circumstances when there is a deficit of plan assets relative to the accumulated benefits obligation. Under UK GAAP, there is no such requirement.

### Restructuring costs

Under UK GAAP, provisions are made for restructuring costs once a detailed formal plan is in place and valid expectations have been raised in those affected that the restructuring will be carried out. US GAAP requires a number of specific criteria to be met before such costs can be recognised as an expense. Among these are the requirements that costs associated with exit or disposal activities are recognised when the costs are incurred rather than at the date of commitment to an exit or disposal plan. To the extent that restructuring costs are related to the activities of the acquired company, US GAAP allows them to be recognised as a liability upon acquisition.

### Intangible assets

such deferral is not permitted except in certain defined circumstances.

### Financial instruments and hedging activities

Under US GAAP, all derivative instruments should be recognised as assets or liabilities in the balance sheet at fair value. Gains and losses are recognised in net income unless they are regarded as hedges. Under UK GAAP, these instruments are measured at cost and gains or losses deferred until the underlying transactions occur.

Under US GAAP, marketable securities are recognised at fair value, with movements in fair value taken to a separate component of equity. Under UK GAAP, such investments are held at cost.

### Deferred income

Under UK GAAP, profits or losses from the sale of product related intangible assets are generally taken to other operating income at disposal and are stated after taking account of product disposal costs and costs of minor outstanding obligations. Under US GAAP, such profits are deferred and recognised in the income statement in subsequent periods until all disposal obligations and commitments have been completed.

### Stock-based compensation

In the Group's Financial Statements prepared under UK GAAP, no cost is accrued for the share options awarded to employees under the AstraZeneca Share Option Plan and the AstraZeneca Savings-Related Share Option Plan as the exercise price is equivalent to the market value at the date of grant. Under US GAAP, the

between the standards relate to classification. Under FRS 1, the Company presents its cash flows for (a) operating activities; (b) dividends received from joint ventures and associates; (c) returns on investments and servicing of finance; (d) tax paid; (e) capital expenditure and financial investment; (f) acquisitions and disposals; (g) dividends paid to shareholders; (h) management of liquid resources; and (i) financing. SFAS No. 95 requires only three categories of cash flow activity being (a) operating; (b) investing; and (c) financing.

Cash flows from taxation, returns on investments and servicing of finance and dividends received from joint ventures and associates under FRS 1 would be included as operating activities under SFAS No. 95; capital expenditure and financial investment and acquisitions and disposals would be included as investing activities; and distributions would be included as a financing activity under SFAS No. 95. Under FRS 1 cash comprises cash in hand and deposits repayable on demand, less overdrafts repayable on demand; and liquid resources comprise current asset investments held as readily disposable stores of value. Under SFAS No. 95 cash equivalents, comprising short term highly liquid investments, generally with original maturities of three months or less, are grouped together with cash; short term borrowings repayable on demand would not be included within cash and cash equivalents and movements on those borrowings would be included in financing activities.

### New accounting standards

Under UK GAAP, AstraZeneca capitalises certain defined software costs and amortises these over five years. Under US GAAP, software costs are generally capitalised and amortised over three to five years.

Under UK GAAP certain payments for rights to compounds in development are capitalised. Under US GAAP these payments are expensed.

#### **Foreign exchange**

Under UK GAAP, unrealised gains and losses on foreign currency transactions to hedge anticipated, but not firmly committed, foreign currency transactions may be deferred and accounted for at the same time as the anticipated transactions. Under US GAAP,

cost is calculated as the difference between the option price and the market price at the date of grant or, for variable plans, at the end of the reporting period (until measurement date). Under the requirements of APB Opinion No. 25 any compensation cost would be charged over the period from the date the options are granted to the date they are first exercisable. Under US GAAP, in the net income reconciliation, the Group has adjusted for stock-based compensation costs calculated under APB Opinion No. 25.

#### **Statement of cash flows: Basis of preparation**

AstraZeneca's statement of Group cash flow is prepared in accordance with UK Financial Reporting Standard 1 (Revised 1996) (FRS 1), whose objective and principles are similar to those set out in SFAS No. 95, Statement of Cash Flows. The principal differences

FIN No. 46R Consolidation of Variable Interest Entities (VIE) is intended to address perceived weaknesses in accounting for special purpose or off-balance sheet entities and provides guidance on identifying the primary beneficiary resulting from arrangements or financial interests as opposed to voting rights. If a party is a primary beneficiary then the assets, liabilities and results of the VIE should be included in the consolidated financial statements of the party. FIN No. 46R applied to all VIEs or potential VIEs referred to as special purpose entities for periods ending on or after 15 December 2003. Adoption for all other entities was required for periods ending on or after 15 March 2004. FIN No. 46R did not have a material effect on the results or net assets of AstraZeneca.

In March 2004, the Emerging Issues Task Force (EITF) issued EITF Issue No. 03-6 Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share. This guidance addressed changes in the reporting and calculation requirements for earnings per share, setting out the method to be used when a company has granted holders of any form of security rights to participate in the earnings of the company along with the participation rights of common stockholders. The adoption of EITF 03-6 had no effect on AstraZeneca.

In June 2004, the EITF issued EITF Issue No. 03-1 The Meaning of Other Than Temporary Impairment and Its Application to Certain Investments. The guidance details how to determine the meaning of other than temporary impairment and its application to debt and equity securities within the scope of SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115) and to equity securities that are not subject to the scope of SFAS No. 115 and are not accounted for under the equity method of accounting. The guidance also includes accounting considerations subsequent to the recognition of an impairment other than temporary and requires certain disclosures about unrealised losses that have not been recognised as other than temporary impairments. These disclosure requirements became effective for periods ended prior to 30 June 2004. The introduction of recognition and measurement guidance of EITF 03-1 has been deferred. The disclosure requirements did not have a significant effect on AstraZeneca; it is not expected that the recognition and measurement requirements will have a material impact either.

In November 2004, the FASB issued

In December 2004, the FASB issued SFAS No. 152 Accounting for Real Estate Timesharing Transactions, an amendment of FASB Statements No. 66 and 67 which provides that real estate time-sharing transactions should be accounted for as non-retail land sales. SFAS No. 152 is effective for fiscal years beginning after 15 June 2005. The adoption of SFAS No. 152 is not expected to have a material effect on the net assets or results of AstraZeneca.

In December 2004, the FASB issued SFAS No. 153 Exchanges of Non-monetary Assets, an amendment of APB Opinion No. 29 which replaces the current exception from fair value measurement for non-monetary exchanges of similar productive assets with a general exception from fair value measurement for exchanges of non-monetary assets that do not have commercial substance. SFAS No. 153 shall be applied prospectively and is effective for non-monetary asset exchanges occurring in fiscal periods beginning after 15 June 2005. The adoption of SFAS No. 153 is not expected to have a material effect on the results or net assets of AstraZeneca.

In December 2004, the FASB issued SFAS No. 123(R) Share-Based Payment that will require compensation costs related to share-based payment transactions to be recognised in the financial statements. With limited exceptions, the amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognised over the period that an employee provides service in exchange for the award. Statement 123(R) replaces SFAS No. 123, Accounting for Stock-Based



SFAS No. 151 Inventory Costs to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after 15 June 2005. The adoption of SFAS No. 151 is not expected to have a material effect on the results or net assets of AstraZeneca.

Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. The effective date of SFAS No. 123(R) is accounting periods commencing on or after 15 June 2005. The standard should be applied using the modified prospective method although there are transitional arrangements for modified retrospective application if the disclosure or recognition requirements of SFAS No. 123 had previously been adopted. AstraZeneca has not yet determined the effect of the adoption of SFAS No. 123(R).

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## Additional Information for US Investors continued

### Differences between UK and US accounting principles (continued)

#### Net income

As a result of the significant difference between the UK GAAP and US GAAP treatment of the combination of Astra and Zeneca in the year of acquisition, and in the results of preceding periods, condensed statements of operations and cash flow under US GAAP have been prepared for the benefit of US investors.

The following is a summary of the adjustments to net income and shareholders' equity which would have been required if US GAAP had been applied instead of UK GAAP.

	2004 \$m	2003 \$m	2002 \$m
Net income, as shown in the consolidated statements of income before exceptional items	3,527	3,036	3,186
Exceptional items after tax	286		(350)
<b>Net income for the period under UK GAAP</b>	<b>3,813</b>	3,036	2,836
<b>Adjustments to conform to US GAAP</b>			
Purchase accounting adjustments (including goodwill and intangibles)			
Deemed acquisition of Astra			
Amortisation and other acquisition adjustments	(1,014)	(952)	(864)
Others	49	59	55
Capitalisation, less disposals and amortisation of interest	(1)	17	46
Deferred taxation			
On fair values of Astra	283	266	239
Others	90	(91)	(99)
Pension and other post-retirement benefits expense	(52)	(43)	(46)
Software costs	6	(18)	(46)
Stock-based compensation	11	(12)	33
Fair value of financial instruments	(94)	10	93

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Research and development	(31)		
Deferred income recognition		14	61
Unrealised losses on foreign exchange and others	(9)	(18)	(1)
<b>Net income in accordance with US GAAP</b>	<b>3,051</b>	<b>2,268</b>	<b>2,307</b>

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**Differences between UK and US accounting principles (continued)****US GAAP Condensed Consolidated Statement of Operations**

<b>For the years ended 31 December</b>	<b>2004</b>	2003	2002
	<b>\$m</b>	\$m	\$m
Sales	<b>21,426</b>	18,849	17,841
Cost of sales	<b>(5,150)</b>	(4,469)	(4,520)
Distribution costs	<b>(177)</b>	(162)	(141)
Research and development	<b>(3,858)</b>	(3,451)	(3,069)
Selling, general and administrative expenses	<b>(7,889)</b>	(6,941)	(6,165)
Amortisation of intangibles	<b>(953)</b>	(881)	(1,052)
Other income	<b>534</b>	225	308
<b>Operating income</b>	<b>3,933</b>	3,170	3,202
Net interest (expense)/income	<b>(1)</b>	63	140
<b>Income from continuing operations before taxation</b>	<b>3,932</b>	3,233	3,342
<b>Taxes on income from continuing operations</b>	<b>(881)</b>	(965)	(1,035)
<b>Net income from continuing operations</b>	<b>3,051</b>	2,268	2,307
<b>Net income for the year</b>	<b>3,051</b>	2,268	2,307
Weighted average number of \$0.25 Ordinary Shares in issue (millions)	<b>1,673</b>	1,709	1,733
Dilutive impact of share options outstanding (millions)	<b>2</b>	3	2
Diluted weighted average number of \$0.25 Ordinary Shares in accordance with US GAAP (millions)	<b>1,675</b>	1,712	1,735
Net income per \$0.25 Ordinary Share and ADS in accordance with USG AAP basic and diluted	<b>\$1.82</b>	\$1.33	\$1.33

**US GAAP Statement of Comprehensive Income**

	<b>2004</b>	2003	2002
<b>For the years ended 31 December</b>	<b>\$m</b>	\$m	\$m
Net income for the year	<b>3,051</b>	2,268	2,307
Exchange gains, net of tax	<b>2,106</b>	3,635	2,919
Other movements, net of tax	<b>20</b>	(81)	(73)
Total comprehensive income	<b>5,177</b>	5,822	5,153

Other movements in 2004 include a reduction in the minimum liability under SFAS No. 87 Employers Accounting for Pensions from \$39m to \$36m. Tax effects on exchange gains/(losses) were \$(82)m and on other movements \$27m.

The cumulative exchange gains and losses (net of tax) on the translation of foreign currency financial statements under US GAAP are set out in the following note:

	<b>2004</b>	2003	2002
<b>For the years ended 31 December</b>	<b>\$m</b>	\$m	\$m
Balance at 1 January	<b>2,236</b>	(1,399)	(4,318)
Movement in year	<b>2,106</b>	3,635	2,919
Balance at 31 December	<b>4,342</b>	2,236	(1,399)

The cumulative total of other movements (net of tax) at 31 December 2004 was a charge of \$134m (2003 \$154m, 2002 \$73m).

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## Additional Information for US Investors continued

### Differences between UK and US accounting principles (continued)

#### Stock-based compensation

In the Group's Financial Statements prepared under UK GAAP, no cost is accrued for the share options awarded to employees under the AstraZeneca Share Option Plan, and the AstraZeneca Savings-Related Share Option Plan as the exercise price is equivalent to the market value at the date of grant. Under US GAAP the cost is calculated as the difference between the option price and the market price at the date of grant or, for variable plans, at the end of the reporting period (until measurement date). Under the requirements of APB Opinion No. 25 any compensation cost would be amortised over the period from the date the options are granted to the date they are first exercisable. Under US GAAP in the net income reconciliation, the Group has adjusted for stock compensation costs as calculated under APB Opinion No. 25. SFAS No.123 Accounting for Stock-Based Compensation sets out an alternative methodology for recognising the compensation cost based on the fair value at grant date. Had the Group adopted this methodology, the incremental effect on net income under US GAAP is shown below:

	<b>2004</b>	2003	2002
	<b>\$m</b>	\$m	\$m
Net income under US GAAP as reported	<b>3,051</b>	2,268	2,307
Compensation cost under APB No. 25	<b>(11)</b>	12	(33)
Compensation cost under SFAS No. 123	<b>(147)</b>	(154)	(122)
Pro forma net income	<b>2,893</b>	2,126	2,152
Pro forma net income per \$0.25 Ordinary Share and ADS in accordance with US GAAP (basic and diluted):			
As reported	<b>\$1.82</b>	\$1.33	\$1.33
Pro forma	<b>\$1.73</b>	\$1.24	\$1.24

The fair value of options granted is estimated, based on the stock price at the grant date, using the Black-Scholes option pricing model with the following assumptions:

	<b>2004</b>	2003	2002
Dividend yield	<b>2.3%</b>	2.0%	1.6%
Expected volatility	<b>25.0%</b>	25.0%	30.0%
Risk-free interest rate	<b>3.5%</b>	4.3%	5.2%

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Expected lives: AstraZeneca Share Option Plan	<b>6.0 years</b>	6.0 years	6.0 years
Expected lives: SAYE Plan	<b>3.8 years</b>	4.3 years	4.3 years

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for US Investors**131****Differences between UK and US accounting principles (continued)****Pension and post-retirement benefits**

For the purposes of US GAAP, the pension information as set out in Note 28 in respect of the UK retirement plans and of the retirement plans of the non-UK subsidiaries has been restated in the following tables in accordance with the requirements of SFAS No. 132 Employers Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88 and 106. These plans comprise substantially all of the actuarial liabilities of all AstraZeneca retirement plans. The changes in projected benefit obligations, plan assets and details of the funded status of these retirement plans, together with the changes in the accumulated other post-retirement benefit obligations, under SFAS No. 132 are as follows:

<b>Change in projected benefit obligation</b>	<b>Pension benefits</b>		<b>Other post-retirement benefits</b>	
	<b>2004 \$m</b>	<b>2003 \$m</b>	<b>2004 \$m</b>	<b>2003 \$m</b>
Benefit obligation at beginning of year	<b>7,416</b>	5,943	<b>242</b>	210
Service cost	<b>229</b>	171	<b>11</b>	9
Interest cost	<b>385</b>	329	<b>14</b>	14
Participant contributions	<b>30</b>	26	<b>1</b>	1
Actuarial loss/(gain)	<b>328</b>	545	<b>(3)</b>	24
<b>Special termination benefits</b>				
Settlement and curtailment	<b>10</b>	5		
Benefits paid	<b>(281)</b>	(245)	<b>(18)</b>	(19)
Exchange	<b>590</b>	642	<b>2</b>	3
Benefit obligation at end of year	<b>8,707</b>	7,416	<b>249</b>	242

<b>Change in plan assets</b>	<b>Pension benefits</b>		<b>Other post-retirement benefits</b>	
	<b>2004 \$m</b>	<b>2003 \$m</b>	<b>2004 \$m</b>	<b>2003 \$m</b>
Fair value at beginning of year	<b>5,905</b>	4,549	<b>195</b>	133



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Actual return on plan assets	<b>565</b>	590	<b>22</b>	35
Group contribution	<b>280</b>	489	<b>17</b>	43
Participant contributions	<b>30</b>	26		1
Settlement and curtailment				
Benefits paid	<b>(281)</b>	(245)	<b>(17)</b>	(17)
Exchange	<b>473</b>	496		
Fair value of plan assets at end of year	<b>6,972</b>	5,905	<b>217</b>	195
Funded status of plans	<b>(1,735)</b>	(1,511)	<b>(32)</b>	(47)
Unrecognised net loss	<b>1,644</b>	1,503	<b>29</b>	36
Prior service cost not recognised	<b>15</b>	25	<b>(11)</b>	(9)
Unrecognised net obligation on implementation	<b>(1)</b>	(1)	<b>25</b>	29
	<b>(77)</b>	16	<b>11</b>	9
Adjustments to recognise minimum liability:				
Intangible assets	<b>(36)</b>	(39)		
Accumulated other comprehensive income	<b>(217)</b>	(260)		
Accrued benefit asset/(liability)	<b>(330)</b>	(283)	<b>11</b>	9

At 31 December 2004, the projected benefit obligation, accumulated benefit obligation and fair value of the plan assets in respect of the pension plans above with accumulated benefit obligations in excess of plan assets were \$6,699m, \$5,800m and \$5,220m, (2003 \$5,779m, \$4,961m and \$4,415m) respectively. The total of accumulated benefit obligations for the pension plans was \$7,443m (2003 \$6,239m). The measurement date for the plan assets and benefit obligations set out above was 31 December 2004. Contributions to the plans in 2005 are estimated to be \$224m.

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## Additional Information for US Investors continued

### Differences between UK and US accounting principles (continued)

Assumed discount rates and rates of increase in remuneration used in calculating the projected benefit obligations together with long term rates of return on plan assets vary according to the economic conditions of the country in which the retirement plans are situated. The weighted average rates used for calculation of year end benefit obligations and forecast benefit cost in the retirement plans and other benefit obligations for SFAS No. 132 purposes were as follows:

	Pension benefits			Other post-retirement benefits		
	2004 %	2003 %	2002 %	2004 %	2003 %	2002 %
Discount rate	5.2	5.5	5.8	5.7	5.9	6.6
Long term rate of increase in remuneration	3.9	4.0	4.1	n/a	n/a	n/a
Expected long term return on assets	6.8	6.6	6.4	7.8	7.8	7.8

The Group has assumed a long term rate of increase in healthcare costs of 8%, reducing to 4%.

	Pension benefits			Other post-retirement benefits		
	2004 \$m	2003 \$m	2002 \$m	2004 \$m	2003 \$m	2002 \$m
<b>Net periodic cost</b>						
Service cost – present value of benefits accruing during the year	229	171	146	11	9	8
Interest cost on projected benefit obligations	385	329	287	14	14	14
Expected return on assets	(406)	(308)	(276)	(15)	(14)	
Net amortisation and deferral	76	45	34	3	2	(1)
Net periodic cost for the year	284	237	191	13	11	21

It is estimated that a one percentage point change in the weighted average healthcare costs trend would have the following effects on the accumulated benefit obligation and net periodic cost at 31 December 2004:

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	One percentage point	
	Increase \$m	Decrease \$m
Accumulated benefit obligation	15	(13)
Net periodic cost	2	(2)

The weighted average allocation of pension and other post-retirement plan assets was as follows:

	2004 %	2003 %
Equities	49.7	49.2
Bonds	36.0	48.8
Other	14.3	2.0

The benefits expected to be paid in the future are as follows:

	\$m
2005	326
2006	337
2007	349
2008	362
2009	376
2010 - 2014	1,761

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**Differences between UK and US accounting principles (continued)****Taxation**

<b>Years ended 31 December</b>	<b>2004 \$m</b>	<b>2003 \$m</b>	<b>2002 \$m</b>
<b>Taxes on income from continuing operations</b>			
UK taxation			
Corporation tax	<b>379</b>	138	165
Double taxation relief	<b>(22)</b>	(23)	(7)
Adjustment in respect of prior period	<b>(178)</b>		
Deferred taxation	<b>(47)</b>	88	40
Overseas taxation			
Overseas taxes	<b>992</b>	878	921
Adjustments in respect of prior periods	<b>7</b>	35	(51)
Deferred taxation	<b>(250)</b>	(151)	(33)
Share of taxation of joint ventures and associates			
<b>Taxes on income from continuing operations</b>	<b>881</b>	965	1,035

The table below reconciles the UK statutory tax charge with the Group's actual charge on income from continuing operations.

<b>Years ended 31 December</b>	<b>2004 \$m</b>	<b>2003 \$m</b>	<b>2002 \$m</b>
Income on continuing operations	<b>3,932</b>	3,233	3,342
Taxation charge at UK corporation tax rate of 30% for 2004 (30% for 2003, 30% for 2002)	<b>1,180</b>	970	1,002
Differences in effective overseas tax rates	<b>27</b>	(41)	6
Items not deductible for tax purposes	<b>40</b>	89	83
Items not chargeable for tax purposes	<b>(71)</b>	(88)	(110)
Adjustments in respect of prior periods	<b>(171)</b>	35	(51)
Exceptional items	<b>(124)</b>		105

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<b>Tax on income from continuing operations</b>	<b>881</b>	965	1,035
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In 2004, claims amounting to \$nil (2003 \$95m) for tax relief were made arising as a result of a restructuring of the AMI joint venture in 1998. Under US GAAP, these reliefs are adjusted against the goodwill arising on the restructuring and included in other adjustments.

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AstraZeneca Annual Report and  
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for US Investors**Additional Information for US Investors** continued**Differences between UK and US accounting principles** (continued)

<b>Shareholders equity</b>	<b>2004 \$m</b>	2003 \$m
Total shareholders equity under UK GAAP	<b>14,418</b>	13,178
<b>Adjustments to conform to US GAAP</b>		
Purchase accounting adjustments (including goodwill and intangibles)		
Deemed acquisition of Astra		
Goodwill	<b>15,099</b>	14,311
Tangible and intangible fixed assets	<b>6,988</b>	7,661
Others	<b>206</b>	145
Capitalisation, less disposals and amortisation of interest	<b>254</b>	255
Deferred taxation		
On fair value of Astra	<b>(2,134)</b>	(2,313)
Others	<b>(92)</b>	(207)
Dividend	<b>1,061</b>	914
Pension and other post-retirement benefits expense	<b>(573)</b>	(534)
Software costs capitalised	<b>52</b>	46
Fair value of financial instruments	<b>2</b>	109
Deferred income recognition		
Others	<b>33</b>	89
<b>Shareholders equity in accordance with US GAAP</b>	<b>35,314</b>	33,654

**Acquired intangible assets**

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Details of the carrying amounts of intangible fixed assets and past and projected amortisation expenses are set out below.

	2004		2003	
	Gross carrying amount \$m	Accumulated amortisation \$m	Gross carrying amount \$m	Accumulated amortisation \$m
Product rights	14,590	(6,744)	13,733	(5,274)
Marketing and distribution rights	1,729	(1,043)	1,659	(831)
Software	589	(367)	462	(305)
Others	460	(360)	421	(329)
<b>Total</b>	<b>17,368</b>	<b>(8,514)</b>	<b>16,275</b>	<b>(6,739)</b>

### Aggregate amortisation expense

	\$m
For year ended 31 December 2004	1,316
For year ended 31 December 2003	1,245
For year ended 31 December 2002	1,154

### Estimated amortisation expense

	\$m
For year ended 31 December 2005	1,316
For year ended 31 December 2006	1,304
For year ended 31 December 2007	1,216
For year ended 31 December 2008	1,216
For year ended 31 December 2009	1,216

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**Differences between UK and US accounting principles  
(continued)**

The weighted average amortisation period in respect of each class of intangible asset is as follows:

Product rights	13 years
Marketing and distribution rights	16 years
Software	4 years
Other	8 years

**Goodwill**

The changes in the carrying amount of goodwill for the two years ended 31 December 2004 were as follows:

	\$m
Balance as at 1 January 2003	13,647
Acquired	1
Exchange adjustments	1,658
<b>Balance as at 1 January 2004</b>	<b>15,306</b>
Exchange and other movements	837
<b>Balance as at 31 December 2004</b>	<b>16,143</b>

**US GAAP Condensed Consolidated Statement of Cash Flows**

<b>For the years ended 31 December</b>	<b>2004 \$m</b>	2003 \$m	2002 \$m
Cash flows from operating activities	<b>4,842</b>	3,416	4,833
Cash flows from investing activities			
Movement in short term investments and fixed deposits	<b>(862)</b>	771	(806)
New fixed asset investments	<b>(117)</b>	(120)	(1)
Disposal of fixed assets	<b>35</b>	38	66
Acquisitions and disposals	<b>355</b>	80	
Capital expenditure	<b>(1,183)</b>	(1,515)	(1,608)



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Net cash outflows from investing activities	<b>(1,772)</b>	(746)	(2,349)
Net cash flow before financing	<b>3,070</b>	2,670	2,484
Cash flows from financing activities			
Equity dividends paid	<b>(1,378)</b>	(1,222)	(1,234)
Re-purchase of AstraZeneca PLC Ordinary Shares	<b>(2,110)</b>	(1,107)	(1,154)
Net increase/(decrease) in short term borrowings	<b>2</b>		(13)
New loans/(loans repaid)	<b>725</b>	(345)	(105)
Net cash outflows from financing activities	<b>(2,761)</b>	(2,674)	(2,506)
Increase/(decrease) in cash	<b>309</b>	(4)	(22)
Cash:			
At 1 January	<b>581</b>	524	510
Increase/(decrease) in cash	<b>309</b>	(4)	(22)
Exchange movements	<b>23</b>	61	36
At 31 December	<b>913</b>	581	524

Interest paid was \$62m in 2004 (2003 \$32m, 2002 \$96m). Interest received was \$119m in 2004 (2003 \$117m, 2002 \$142m). Tax paid was \$1,246m in 2004 (2003 \$886m, 2002 \$795m).

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Group Financial Record UK GAAP

# Group Financial Record UK GAAP

For the years ended 31 December	2000 \$m	2001 \$m	2002 \$m	2003 \$m	2004 \$m
<b>Turnover and profits</b>					
Group turnover	17,882	16,222	17,841	18,849	<b>21,426</b>
Cost of sales	(5,270)	(4,232)	(4,520)	(4,469)	<b>(5,150)</b>
Distribution costs	(286)	(122)	(141)	(162)	<b>(177)</b>
Research and development	(2,893)	(2,773)	(3,069)	(3,451)	<b>(3,803)</b>
Selling, general and administrative expenses	(5,691)	(5,509)	(6,348)	(6,856)	<b>(7,841)</b>
Other income	266	368	243	200	<b>315</b>
Group operating profit	4,008	3,954	4,006	4,111	<b>4,770</b>
Group operating profit before exceptional items	4,330	4,156	4,356	4,111	<b>4,770</b>
Exceptional items charged to operating profit	(322)	(202)	(350)		
Profit on sale of interest in joint venture					<b>219</b>
Share of operating profit of joint ventures and associates	(149)				
Exceptional items	(150)				
Profits on sale of fixed assets		10			
Dividend income	3	8	1	2	<b>6</b>
Net interest	135	105	30	89	<b>90</b>
Profit on ordinary activities before taxation	3,847	4,077	4,037	4,202	<b>5,085</b>
Taxation	(1,560)	(1,160)	(1,177)	(1,143)	<b>(1,254)</b>

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Profit on ordinary activities after taxation	2,287	2,917	2,860	3,059	<b>3,831</b>
Attributable to minorities	(10)	(11)	(24)	(23)	<b>(18)</b>
Net profit for the financial year	2,277	2,906	2,836	3,036	<b>3,813</b>
<b>Return on sales</b>					
Group operating profit before exceptional items as a percentage of sales	24.2%	25.6%	24.4%	21.8%	<b>22.3%</b>
<b>Ratio of earnings to fixed charges (UK GAAP)</b>	25.2	42.8	45.6	103.5	<b>98.2</b>

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Group Financial Record UK GAAP

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At 31 December	2000 \$m	2001 \$m	2002 \$m	2003 \$m	2004 \$m
<b>Balance sheet</b>					
Fixed assets (tangible and intangible) and goodwill	7,908	8,109	9,404	10,420	10,909
Fixed asset investments	11	23	46	220	267
Current assets	10,938	10,364	12,126	12,933	14,440
Total assets	18,857	18,496	21,576	23,573	25,616
Creditors due within one year	(6,897)	(6,480)	(8,215)	(7,695)	(7,782)
Total assets less current liabilities	11,960	12,016	13,361	15,878	17,834
Creditors due after more than one year	(927)	(787)	(362)	(355)	(1,108)
Provisions for liabilities and charges	(1,617)	(1,600)	(1,773)	(2,266)	(2,207)
Net assets	9,416	9,629	11,226	13,257	14,519
Shareholders funds equity interests	9,389	9,586	11,172	13,178	14,418
Minority equity interests	27	43	54	79	101
Shareholders funds and minority interests	9,416	9,629	11,226	13,257	14,519
<b>Cash flow</b>					
For the years ended 31 December	2000 \$m	2001 \$m	2002 \$m	2003 \$m	2004 \$m
Net cash inflow from operating activities	4,183	3,762	5,593	4,226	6,061
Returns on investments and servicing of finance	19	156	35	76	58
Tax paid	(648)	(792)	(795)	(886)	(1,246)
Capital expenditure and financial investment	(1,426)	(1,543)	(1,543)	(1,597)	(1,296)
Acquisitions and disposals	740	(44)		80	355
Equity dividends paid to shareholders	(1,220)	(1,236)	(1,234)	(1,222)	(1,378)
Net cash inflow before management of liquid resources and financing	1,648	303	2,056	677	2,554



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Group Financial Record US GAAP

## Group Financial Record US GAAP

### Group Financial Record US GAAP

The selected financial data set out below, for each of the years in the five year period ended 31 December 2004, have been extracted or derived from the audited Financial Statements.

The selected financial data should be read in conjunction with, and are qualified in their entirety by reference to, the Financial Statements of AstraZeneca and the notes thereto, which are included elsewhere in this document.

### Consolidated income statement data

For the years ended 31 December	2000	2001	2002	2003	2004
Net income from operations (\$m)	865	1,397	2,307	2,268	3,051
Net income from operations per \$0.25 Ordinary Share	\$0.49	\$0.79	\$1.33	\$1.33	\$1.82
Diluted income from operations per \$0.25 Ordinary Share	\$0.49	\$0.79	\$1.33	\$1.33	\$1.82
Net income from operations had SFAS No. 142 been adopted	1,716	2,125			
Net and diluted income per \$0.25 Ordinary Share from operations had SFAS No. 142 been adopted	\$0.97	\$1.21			

### Ratio of earnings to fixed charges

For the Group with adjustments to accord with US GAAP	15.5	25.0	36.7	78.9	76.6
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### Consolidated balance sheet data

At 31 December	2000 \$m	2001 \$m	2002 \$m	2003 \$m	2004 \$m
Total assets	41,500	38,081	42,578	45,378	47,527
Shareholders' equity	29,707	27,402	30,183	33,654	35,314

### Merger accounting

For the purpose of US GAAP, the merger has been regarded as a purchase accounting acquisition of Astra by Zeneca.

### Ratio of earnings to fixed charges (UK and US GAAP)

For the purpose of computing these ratios, earnings consist of the income from continuing ordinary activities before taxation of

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Group companies and income received from companies owned 50% or less, plus fixed charges (excluding capitalised interest). Fixed charges consist of interest (including capitalised interest) on all indebtedness, amortisation of debt discount and expense and that portion of rental expense representative of the interest factor.

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## IFRS Restatements

### Introduction

AstraZeneca currently prepares its primary financial statements under UK Generally Accepted Accounting Principles (UK GAAP). From 2005 onwards the Group will be required to prepare its consolidated financial statements in accordance with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS)\* as adopted by the European Union (EU). This change applies to all financial reporting for accounting periods beginning on or after 1 January 2005 and, consequently, AstraZeneca's first IFRS results will be its interim results for Q1 2005. The Group's first Annual Report under IFRS will be for 2005. As the Group publishes comparative information for two years in its Annual Report, the date for transition to IFRS is 1 January 2003, this being the start of the earliest period of comparative information.

To explain how AstraZeneca's reported performance and financial position are affected by this change, information previously published under UK GAAP is restated under IFRS on pages 139 to 146.

As noted below, these financial statements have been prepared on the basis of IFRSs expected to be available at 31 December 2005. These are subject to ongoing review and endorsement by the EU or possible amendment by interpretative guidance from the IASB (International Accounting Standards Board) and are therefore still subject to change. We will update our restated information as necessary for any such changes, should they occur.

### Basis of preparation

The financial information has been prepared in accordance with IFRS as adopted by the EU. The accounting

to be taken directly to reserves, as is required under FRS 17 Retirement Benefits. These amendments, if endorsed by the EU, will be effective for accounting periods commencing on or after 1 January 2006, with earlier adoption encouraged by the IASB. AstraZeneca has adopted the provisions of this amendment in its restated information

- > IFRS 2, IFRS 6 and various IFRIC interpretations and amendments to SIC 12 have not yet been endorsed.

### Accounting policies

#### Basis of accounting

As set out in the Basis of Preparation, the restated financial information on pages 139 to 146, has been prepared in accordance with IAS and IFRS as adopted by the EU.

The accounting policy for financial instruments complies with the EU carve out version of IAS 39. The policies also assume that the amendments to IAS 19 Employee Benefits published in December 2004 by the IASB, allowing actuarial gains and losses to be recognised in full through reserves, will be endorsed by the EU.

AstraZeneca's management considers the following to be the most important accounting policies in the context of the Group's operations.

#### Revenue

Turnover excludes inter-company sales and value-added taxes and represents net invoice value less estimated rebates, returns and settlement discounts. Turnover is recognised when the significant risks and rewards of ownership have been transferred to a third party.

#### Research and development

Research expenditure is charged to income in the year in which it is incurred.

payments and milestones, are capitalised and amortised over their economic lives from launch. Intangible assets relating to products in development (both internally generated and externally acquired) are subject to impairment testing at each balance sheet date or earlier upon indication of impairment. Any impairment losses are written off immediately to income.

#### *Business combinations and goodwill*

On the acquisition of a business, fair values are attributed to the net assets acquired. Goodwill arises where the fair value of the consideration given for a business exceeds the fair value of such net assets.

Goodwill arising on acquisitions is capitalised and subject to impairment review, both annually and when there are indications that the carrying value may not be recoverable. Prior to 1 January 2003, goodwill was amortised over its estimated useful life; such amortisation ceased on 31 December 2002.

The Group's policy up to and including 1997 was to eliminate goodwill arising upon acquisitions against reserves. Under IFRS 1 and IFRS 3, such goodwill will remain eliminated against reserves.

#### *Employee benefits*

The Group accounts for pensions and similar benefits (principally healthcare) under IAS 19 Employee Benefits. In respect of defined benefit plans, obligations are measured at discounted present value whilst plan assets are recorded at fair value. The operating and financing costs of such plans are recognised separately in the income statement; service costs are spread systematically over the lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are



policies applied are set out on pages 139 to 141.

All IASB standards in issue at December 2004 have been endorsed by the EU, except as noted below:

- > The EU has issued a revised version of IAS 39 referred to as the 'carve out' version and has endorsed this rather than the full IASB standard.
- > The IASB has issued amendments to IAS 19 allowing actuarial gains or losses

\* References to IFRS refer to the application of International Accounting Standards, International Financial Reporting Standards and Standing Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

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Internal development expenditure is charged to income in the year in which it is incurred unless it meets the recognition criteria of IAS 38 Intangible Assets. Regulatory and other uncertainties generally mean that such criteria are not met. Where, however, the recognition criteria are met, intangible assets are capitalised and amortised over their useful economic lives from product launch. Payments to in-license products and compounds from external third parties, generally taking the form of up-front

recognised immediately in the statement of recognised income and expense.

Payments to defined contribution schemes are charged as an expense as they fall due.

*Share-based payments*

The fair value of employee share option plans is calculated using the Black-Scholes model. In accordance with IFRS 2 Share-based Payments the resulting cost is charged to the income statement over the vesting period of the options. The value of the charge is adjusted to reflect expected and actual levels of options vesting.

## IFRS Restatements continued

### *Foreign currencies*

Profit and loss accounts in foreign currencies are translated into US dollars at average exchange rates for the relevant accounting periods. Assets and liabilities are translated at exchange rates prevailing at the date of the Group balance sheet.

Exchange gains and losses on short term foreign currency borrowings and deposits are included within net interest payable. Exchange differences on all other transactions, except relevant foreign currency loans, are taken to operating profit. In the consolidated financial statements, exchange differences arising on consolidation of the net investments in subsidiaries, joint ventures and associates, together with those on relevant foreign currency loans, are taken directly to reserves via the statement of recognised income and expense.

### *Taxation*

The charge for taxation is based on the profits for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and for accounting purposes. Full provision is made for the tax effects of these differences. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the asset can be utilised. This requires judgements to be made in respect of the forecast of future taxable income.

No deferred tax asset or liability is recognised in respect of temporary differences associated with investments in subsidiaries, branches, associates and joint ventures, where the Group is able to control the timing of reversal of the temporary differences and it is probable that the temporary

### *Tangible fixed assets*

The Group's policy is to write off the difference between the cost of each tangible fixed asset and its residual value systematically over its estimated useful life. Reviews are made annually of the estimated remaining lives and residual values of individual productive assets, taking account of commercial and technological obsolescence as well as normal wear and tear. Under this policy it becomes impractical to calculate average assets lives exactly. However, the total lives range from approximately 13 to 50 years for buildings, and three to 15 years for plant and equipment. All tangible fixed assets are reviewed for impairment when there are indications that the carrying value may not be recoverable.

### *Leases*

Assets held under finance leases are capitalised and included in tangible fixed assets at fair value. Each asset is depreciated over the shorter of the lease term or its useful life. The obligations related to finance leases, net of finance charges in respect of future periods, are included, as appropriate, under creditors due within, or creditors due after more than, one year. The interest element of the rental obligation is allocated to accounting periods during the lease term to reflect a constant rate of interest on the remaining balance of the obligation for each accounting period.

Rentals under operating leases are charged to the income statement as incurred.

### *Subsidiaries, associates and joint ventures*

A subsidiary is an entity controlled, directly or indirectly, by AstraZeneca PLC. Control is regarded as the power to govern the financial and operating policies of the entity so as to obtain

is included in the Group income statement on the equity accounting basis. The holding value of significant associates and joint ventures in the Group balance sheet is calculated by reference to AstraZeneca's equity in the net assets of such associates and joint ventures, as shown by the most recent accounts available, adjusted where appropriate and including goodwill on acquisitions made since 1 January 1998.

### *Contingent liabilities*

Through the normal course of business, AstraZeneca is involved in legal disputes, the settlement of which may involve cost to the Group. Provision is made where an adverse outcome is probable and associated costs can be estimated reliably.

AstraZeneca is exposed to environmental liabilities relating to its past operations, principally in respect of soil and groundwater remediation costs. Provisions for these costs are made when there is a present obligation and where it is probable that expenditure on remedial work will be required and that a reliable estimate can be made of the cost.

### *Inventories*

Inventories are stated at the lower of cost or net realisable value. The first in, first out or an average method of valuation is used. For finished goods and work in progress, cost includes directly attributable costs and certain overhead expenses (including depreciation). Selling expenses and certain other overhead expenses (principally central administration costs) are excluded. Net realisable value is determined as estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

differences will not reverse in the foreseeable future.

Accruals for tax contingencies require management to make judgements and estimates of ultimate exposures in relation to tax audit issues and exposures. Tax benefits are not recognised unless the tax positions will probably be sustained. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of that benefit on the basis of a potential settlement through negotiation and/or litigation. Any recorded exposure to the interest on tax liabilities is provided for in the tax charge.

benefits from its activities.

An associate is an undertaking, not being a subsidiary or joint venture, in which AstraZeneca has a participating interest and over whose commercial and financial policy decisions AstraZeneca has the power to exert significant influence.

A joint venture is an entity in which AstraZeneca holds an interest on a long term basis and which is jointly controlled by AstraZeneca and one or more other venturers under a contractual arrangement.

AstraZeneca's share of the profit less losses of all significant joint ventures and associates

#### *Financial instruments*

Financial instruments are recorded initially at fair value. Subsequent measurement depends on the designation of the instrument, as follows:

- > Investments (other than interests in joint ventures, associates and fixed deposits) and short term investments (other than fixed deposits) are normally designated as available for sale. Where the exposure to a change in fair value of such an asset is substantially offset by the exposure to a change in the fair value of derivatives, the asset is generally classified as fair value through profit or loss.
- > Fixed deposits, comprising principally

funds held with banks and other financial institutions, and short term borrowings and overdrafts are classified as loans and receivables and held at amortised cost.

- > Derivatives, comprising interest rate swaps, foreign exchange contracts and options and embedded derivatives, are classified as held for trading. Changes in fair value are taken to the income statement.
- > Long term loans are generally held at amortised cost. Where a derivative financial instrument (generally an interest rate swap) hedges the changes in fair value of a long term loan, any gain or loss on the hedging instrument is recognised in the income statement. The hedged item is also stated at fair value in respect of the risk being hedged, with any gain or loss being recognised in the income statement.

In addition the Group has chosen to restate comparative information with respect to IAS 32, IAS 39 and IFRS 2.

The Group has also opted to adopt the IASB amendments to IAS 19 early, allowing actuarial gains and losses to be charged to reserves in the period in which they arise.

Changes in the fair value of financial instruments are dealt with as follows:

- > For available for sale assets, exchange losses and impairments are taken to the income statement. All other changes in fair value are taken to reserves. On disposal of the related asset, the accumulated changes in fair value recorded in reserves are included in the gain or loss recorded in the income statement.
- > For long term loans effectively hedged, assets at fair value through profit or loss and assets held for trading, all changes in fair value are recognised in the income statement.

#### **IFRS transitional arrangements and early adoption**

When preparing the Group's IFRS balance sheet at 1 January 2003, the date of transition, the following optional exemptions from full retrospective application of IFRS accounting policies

have been adopted:

- > Business combinations the provisions of IFRS 3 have been applied prospectively from 1 January 2003; and
  - > Employee benefits the accumulated actuarial gains and losses in respect of employee defined benefit plans have been recognised in full through reserves.
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IFRS Restatements

## IFRS Restatements continued

## Reconciliation of profit

For the year ended 31 December 2004	Reported under UK GAAP \$m	IFRS 2 Share- based Payments \$m	IAS 19 Employee Benefits \$m	IAS 32/ IAS 39 Financial Instruments \$m	Other \$m	Restated under IFRS \$m
<b>Sales</b>	21,426					21,426
Cost of sales	(5,150)	(2)		(41)		(5,193)
Distribution costs	(177)					(177)
Research and development	(3,803)	(42)	(1)	(24)	403	(3,467)
Selling, general and administrative expenses	(7,841)	(103)	10		(334)	(8,268)
Other operating income	315			(89)		226
<b>Operating profit</b>	4,770	(147)	9	(154)	69	4,547
Net finance costs	90		(8)	(28)	(1)	53
Income from dividends	6					6
Profit on sale of interest in joint venture	219					219
<b>Profit before tax</b>	5,085	(147)	1	(182)	68	4,825
Taxation	(1,254)	(20)	(1)	54	66	(1,155)
<b>Profit for the period</b>	3,831	(167)		(128)	134	3,670
<b>Attributable to:</b>						
Equity holders of the Company	3,813	(167)	(1)	(128)	134	3,651
Minority interest	18		1			19
Basic earnings per \$0.25 Ordinary Share	\$2.28	(\$0.10)	(\$0.00)	(\$0.08)	\$0.08	\$2.18
Diluted earnings per \$0.25 Ordinary Share	\$2.28	(\$0.10)	(\$0.00)	(\$0.08)	\$0.08	\$2.18

**Statement of Recognised Income and Expense**

For the year ended 31 December 2004

\$m

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<b>Net profit for the period</b>	3,651
Foreign exchange adjustments on consolidation	689
Tax on foreign exchange adjustments	379
Valuation gains taken to equity	39
Actuarial gains and losses, net of tax	(98)
<b>Recognised gains and losses for the year</b>	4,660

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Tax on foreign exchange adjustments on consolidation in 2004 includes a credit of \$357m in respect of foreign exchange losses arising in 2000.

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**Reconciliation of profit**

For the year ended 31 December 2003	Reported under UK GAAP \$m	IFRS 2 Share- based Payments \$m	IAS 19 Employee Benefits \$m	IAS 32/ IAS 39 Financial Instruments \$m	Other \$m	Restated under IFRS \$m
<b>Sales</b>	18,849					18,849
Cost of sales	(4,469)	(2)	(2)	11	(1)	(4,463)
Distribution costs	(162)					(162)
Research and development	(3,451)	(42)	(5)		486	(3,012)
Selling, general and administrative expenses	(6,856)	(110)	(7)	4	(424)	(7,393)
Other operating income	200			(12)		188
<b>Operating profit</b>	4,111	(154)	(14)	3	61	4,007
Net finance costs	89		(7)	(24)	(2)	56
Income from dividends	2					2
<b>Profit before tax</b>	4,202	(154)	(21)	(21)	59	4,065
Taxation	(1,143)	18	6	5	85	(1,029)
<b>Profit for the year</b>	3,059	(136)	(15)	(16)	144	3,036
<b>Attributable to:</b>						
Equity holders of the Company	3,036	(136)	(14)	(16)	144	3,014
Minority interest	23		(1)			22
Basic earnings per \$0.25 Ordinary Share	\$1.78	(\$0.08)	(\$0.01)	(\$0.01)	\$0.08	\$1.76
Diluted earnings per \$0.25 Ordinary Share	\$1.78	(\$0.08)	(\$0.01)	(\$0.01)	\$0.08	\$1.76

**Statement of Recognised Gains and Losses**

For the year ended 31 December 2003

\$m



<b>Net profit for the period</b>	3,014
Foreign exchange adjustments on consolidation	1,256
Tax on foreign exchange adjustments	66
Valuation gains taken to equity	10
Actuarial gains and losses, net of tax	(167)
<b>Recognised gains and losses for the year</b>	<b>4,179</b>

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IFRS Restatements

## IFRS Restatements continued

## Reconciliation of equity

As at 31 December 2004	Reported under UK GAAP \$m	IAS 19 Employee Benefits \$m	IAS 32/ IAS 39 Financial Instruments \$m	IAS12 Income Tax \$m	Other \$m	Restated under IFRS \$m
<b>Assets</b>						
<b>Non-current assets</b>						
Property, plant and equipment	8,083				14	8,097
Goodwill and intangible assets	2,826				224	3,050
Other investments	267		(5)			262
Deferred tax assets		548	31	1,016	(1)	1,594
	11,176	548	26	1,016	237	13,003
<b>Current assets</b>						
Inventories	3,020					3,020
Trade and other receivables	6,274	(720)		(781)	(2)	4,771
Short term investments, cash and cash equivalents	5,146		88			5,234
	14,440	(720)	88	(781)	(2)	13,025
<b>Total assets</b>	<b>25,616</b>	<b>(172)</b>	<b>114</b>	<b>235</b>	<b>235</b>	<b>26,028</b>
<b>Liabilities</b>						
<b>Current liabilities</b>						
Short term borrowings, overdrafts and current instalments of loans	(142)					(142)
Other creditors	(7,640)	111	25		1,059	(6,445)
	(7,782)	111	25		1,059	(6,587)
<b>Non-current liabilities</b>						

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Loans	(1,030)	(68)				(1,098)
Retirement benefit obligations		(1,761)				(1,761)
Provisions and deferred tax liabilities	(2,207)	387	(43)	(107)	(8)	(1,978)
Other liabilities	(78)				(8)	(86)
	(3,315)	(1,374)	(111)	(107)	(16)	(4,923)
<b>Total liabilities</b>	(11,097)	(1,263)	(86)	(107)	1,043	(11,510)
<b>Net assets</b>	14,519	(1,435)	28	128	1,278	14,518
<b>Equity</b>						
<b>Capital and reserves attributable to equity holders</b>						
Share capital	411					411
Share premium account	550					550
Other reserves	1,851					1,851
Retained earnings	11,606	(1,417)	28	118	1,278	11,613
	14,418	(1,417)	28	118	1,278	14,425
<b>Minority equity interests</b>	101	(18)		10		93
<b>Total equity and reserves</b>	14,519	(1,435)	28	128	1,278	14,518

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<b>Reconciliation of equity</b>	Reported under UK GAAP \$m	IAS 19 Employee Benefits \$m	IAS 32/ IAS 39 Financial Instruments \$m	IAS 12 Income Tax \$m	Other \$m	Restated under IFRS \$m
As at 31 December 2003	\$m	\$m	\$m	\$m	\$m	\$m
<b>Assets</b>						
<b>Non-current assets</b>						
Property, plant and equipment	7,536				11	7,547
Goodwill and intangible assets	2,884				143	3,027
Other investments	220		(7)		(80)	133
Deferred tax assets		472	2	1,021	19	1,514
	10,640	472	(5)	1,021	93	12,221
<b>Current assets</b>						
Inventories	3,022					3,022
Trade and other receivables	5,960	(643)		(897)		4,420
Short term investments, cash and cash equivalents	3,951		200			4,151
	12,933	(643)	200	(897)		11,593
<b>Total assets</b>	<b>23,573</b>	<b>(171)</b>	<b>195</b>	<b>124</b>	<b>93</b>	<b>23,814</b>
<b>Liabilities</b>						
<b>Current liabilities</b>						
Short term borrowings, overdrafts and current instalments of loans	(152)					(152)
Other creditors	(7,543)	143			994	(6,406)
	(7,695)	143			994	(6,558)
<b>Non-current liabilities</b>						
Loans	(303)					(303)

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Retirement benefit obligations		(1,528)				(1,528)
Provisions and deferred tax liabilities	(2,266)	314	(61)	(132)	(8)	(2,153)
Other liabilities	(52)				(11)	(63)
	(2,621)	(1,214)	(61)	(132)	(19)	(4,047)
<b>Total liabilities</b>	(10,316)	(1,071)	(61)	(132)	975	(10,605)
<b>Net assets</b>	13,257	(1,242)	134	(8)	1,068	13,209
<b>Equity</b>						
<b>Capital and reserves attributable to equity holders</b>						
Share capital	423					423
Share premium account	449					449
Other reserves	1,857					1,857
Retained earnings	10,449	(1,242)	134	(18)	1,068	10,391
	13,178	(1,242)	134	(18)	1,068	13,120
<b>Minority equity interests</b>	79			10		89
<b>Total equity and reserves</b>	13,257	(1,242)	134	(8)	1,068	13,209

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IFRS Restatements

## IFRS Restatements continued

### Consolidated Cash Flow Statement

	2004	2003
For the year ended 31 December	\$m	\$m
<b>Cash flows from operating activities</b>		
Operating profit before taxation	4,547	4,007
Depreciation, amortisation and impairment	1,268	1,293
Increase in working capital	(9)	(1,080)
Other non-cash movements	326	73
Cash from operating activities	6,132	4,293
Interest paid	(69)	(39)
Tax paid	(1,246)	(886)
<b>Net cash inflow from operating activities</b>	<b>4,817</b>	<b>3,368</b>
<b>Cash flows from investing activities</b>		
Disposal of business operations	355	80
Movement in short term investments and fixed deposits	1,855	617
Purchases of property, plant and equipment	(1,063)	(1,282)
Disposals of property, plant and equipment	35	38
Purchase of intangible assets	(215)	(293)
Purchase of fixed asset investments	(117)	(120)
Interest received	119	117
Dividends paid by subsidiaries to minority interests	(5)	(11)
Dividends received	6	2
<b>Net cash inflow/(outflow) from investing activities</b>	<b>970</b>	<b>(852)</b>
<b>Cash flows from financing activities</b>		

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Proceeds from issue of share capital	102	47
Repurchase of shares	(2,212)	(1,154)
Increase in/(repayment of) loans	725	(345)
Dividends paid	(1,378)	(1,222)
Increase in short term borrowings	2	
<b>Net cash outflow from financing activities</b>	<b>(2,761)</b>	<b>(2,674)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>3,026</b>	<b>(158)</b>
Cash and cash equivalents at the beginning of the period	872	968
Exchange movements (cash and cash equivalents)	29	62
<b>Cash and cash equivalents at the end of the period</b>	<b>3,927</b>	<b>872</b>
<b>Cash and cash equivalents consists of:</b>		
Cash and cash equivalents	4,067	1,024
Overdrafts	(140)	(152)
	<b>3,927</b>	<b>872</b>

**Reconciliation of Net Cash and Debt**

	2004 \$m	2003 \$m
For the year ended 31 December		
Increase/(decrease) in cash and cash equivalents	3,026	(158)
Cash (inflow)/outflow from (increase)/decrease in loans and short term borrowings	(727)	345
Cash inflow from decrease in short term investments	(1,855)	(617)
Change in net funds resulting from cash flows	444	(430)
Exchange movements (cash and debt)	34	82
Movement in net funds UK GAAP	478	(348)
Fair value adjustments	(180)	(13)
<b>Movement in net funds</b>	<b>298</b>	<b>(361)</b>

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## Shareholder Information

<b>AstraZeneca</b>	2000	2001	2002	2003	2004
<b>Ordinary Shares in issue</b> millions					
At year end	1,766	1,745	1,719	1,693	<b>1,645</b>
Weighted average for year	1,768	1,758	1,733	1,709	<b>1,673</b>
<b>Stock market price</b> per \$0.25 Ordinary Share					
Highest (pence)	3600	3555	3625	2868	<b>2749</b>
Lowest (pence)	1926	2880	1799	1820	<b>1863</b>
At year end (pence)	3375	3098	2220	2680	<b>1889</b>
Earnings per \$0.25 Ordinary Share before exceptional items	\$1.62	\$1.73	\$1.84	\$1.78	<b>\$2.11</b>
Earnings per \$0.25 Ordinary Share (basic)	\$1.30	\$1.65	\$1.64	\$1.78	<b>\$2.28</b>
Earnings per \$0.25 Ordinary Share (diluted)	\$1.30	\$1.65	\$1.64	\$1.78	<b>\$2.28</b>
Dividends	\$0.70*	\$0.70	\$0.70	\$0.795	<b>\$0.94</b>

\* In addition, shareholders received a distribution of shares in Syngenta AG as a dividend in specie in respect of the demerger of Zeneca Agrochemicals.

### Percentage analysis at 31 December 2004 of issued share capital

By size of account	2004
No. of shares	%
1 250	<b>0.6</b>
251 500	<b>0.8</b>
501 1,000	<b>1.0</b>
1,001 5,000	<b>1.5</b>
5,001 10,000	<b>0.2</b>
10,001 50,000	<b>1.2</b>
50,001 1,000,000	<b>12.4</b>
over 1,000,000	<b>82.3</b>
Issued share capital	<b>100.0</b>



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Includes VPC and ADR holdings

At 31 December 2004, AstraZeneca PLC had 161,077 registered holders of 1,645,051,891 Ordinary Shares of \$0.25 each. In addition, there were approximately 45,000 holders of American Depositary Receipts (ADRs) representing 8.82% of the issued share capital and 161,000 holders of shares held under the VPC Services Agreement representing 22.63% of the issued share capital. The ADRs, each of which is equivalent to one Ordinary Share, are issued by JPMorgan Chase Bank.

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## Shareholder Information continued

### AstraZeneca PLC

Since April 1999, following the AstraZeneca merger, the principal markets for trading in the shares of AstraZeneca PLC are the London, Stockholm and New York Stock Exchanges. The table below sets forth, for the four quarters of 2003 and for the first two quarters and last six months of 2004 the reported high and low share prices of AstraZeneca PLC, on the following bases:

- > for shares listed on the London Stock Exchange ( LSE ) the reported high and low middle market closing quotations are derived from The Daily Official List;
- > for shares listed on the Stockholm Stock Exchange ( SSE ) the high and low closing sales prices are as stated in the Official List;
- > for American Depositary Shares ( ADS ) listed on the New York Stock Exchange the reported high and low sales prices are as reported by Dow Jones (ADR quotations).

		Ordinary LSE		ADS		AstraZeneca Ordinary SSE*	
		High (pence)	Low (pence)	High (US\$)	Low (US\$)	High (SEK)	Low (SEK)
2003	Quarter 1	2268	1820	35.75	29.98	311.5	245
	Quarter 2	2696	2185	45.67	34.35	355	288
	Quarter 3	2695	2370	43.76	38.45	355.5	312
	Quarter 4	2868	2551	49.47	44.10	382	328
2004	Quarter 1	2749	2507	50.85	46.29	374	336.5
	Quarter 2	2709	2474	49.29	45.64	373	342
	July	2482	2282	45.72	43.01	346	319
	August	2555	2374	46.53	43.92	347	328.5
	September	2665	2265	47.13	41.13	359.5	301
	October	2290	2103	41.20	37.97	301.5	277.5
	November	2367	2045	44.14	39.39	305	264.5
	December	2116	1863	41.11	35.88	276	237.5

\*Principally held in bearer form

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During 2004 AstraZeneca's share re-purchase programme which was introduced in 1999 continued with the re-purchase and subsequent cancellation of 50.1 million shares at a total cost of \$2,212m, representing 3.0 per cent of the total issued share capital of the Company. The average price paid per share in 2004 was 2376 pence. Between 1999 and 2003 a total of 92.8 million Ordinary Shares were re-purchased, and subsequently cancelled, at an average price of 2762 pence per share for a consideration, including expenses, of \$3,959m. The excess of the consideration over the nominal value was charged against the profit and loss account reserve. Shares issued in respect of share schemes totalled 2.5 million.

In 1999, in connection with the merger, AstraZeneca's share capital was redenominated in US dollars. On 6 April 1999, Zeneca shares were cancelled and US dollar shares issued, credited as fully paid on the basis of one dollar share for each Zeneca share then held. This was achieved by a reduction of capital under section 135 of the Companies Act 1985. Upon the reduction of capital becoming effective, all issued and unissued Zeneca shares were cancelled and the sum arising as a result thereof credited to a special reserve which was converted into US dollars at the rate of exchange prevailing on the record date. This US dollar reserve was then applied in paying up, at par, newly created US dollar shares.

At the same time as the US dollar shares were issued, the Company issued 50,000 Redeemable Preference Shares with a nominal value of £1.00 each for cash at par. The Redeemable Preference Shares carry limited class voting rights and no dividend rights. This class of shares is also capable of redemption at par at the option of the Company on the giving of seven days' written notice to the registered holder of the shares.

A total of 826 million AstraZeneca shares were issued to Astra shareholders who accepted the merger offer before the final closing date, 21 May 1999. AstraZeneca received acceptances from Astra shareholders representing 99.6 per cent of Astra's shares and the remaining 0.4 per cent was acquired in 2000 for cash.

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**Major shareholdings**

On 26 January 2005 the following had disclosed an interest in the issued Ordinary Share capital of the Company in accordance with the requirements of Sections 198-208 of the Companies Act 1985:

Shareholder	Number of shares	Date of disclosure to Company*	Percentage of issued share capital
The Capital Group Companies, Inc.	220,352,313	26 Jan 2005	13.39%
Investor AB	63,465,810	11 Feb 2004	3.86%
Wellington Management Co., LLP	53,510,141	28 Jul 2004	3.25%
Legal & General Investment Management Limited	52,518,020	13 Jun 2002	3.19%
Barclays PLC	50,634,731	1 Oct 2004	3.08%

No other person held a notifiable interest in shares, comprising 3% or more of the issued Ordinary Share capital of the Company, appearing in the register of interests in shares maintained under the provisions of Section 211 of the Companies Act 1985.

\* Since the date of disclosure to the Company, the interest of any person listed above in the Ordinary Shares of the Company may have increased or decreased. No requirement to notify the Company of any increase or decrease would have arisen unless the holding moved up or down through a whole number percentage level. The percentage level may increase (on the cancellation of shares following a re-purchase of shares under the Company's share re-purchase programme) or decrease (on the issue of new shares under any of the Company's share plans).

Changes in the percentage ownership held by major shareholders during the past three years are set out below. Major shareholders do not have different voting rights.

Shareholder	Percentage of issued share capital			
	26 Jan 2005	28 Jan 2004	29 Jan 2003	17 Feb 2002
The Capital Group Companies, Inc.	13.39%	15.01%	11.92%	11.09%
Investor AB	3.86%	5.41%	5.33%	5.25%
Wellington Management Co., LLP	3.25%	<3.00%	<3.00%	<3.00%
Legal & General Investment Management Limited	3.19%	3.10%	3.06%	<3.00%
Barclays PLC	3.08%	<3.00%	<3.00%	<3.00%

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AstraZeneca PLC American Depositary Shares (each representing one Ordinary Share) evidenced by American Depositary Receipts issued by JPMorgan Chase Bank, as depositary, are listed on the New York Stock Exchange. As of 26 January 2005, the proportion of Ordinary Shares represented by American Depositary Shares was 8.77% of the Ordinary Shares outstanding.

Number of registered holders of Ordinary Shares as of 26 January 2005:

> In the US	823
> Total	160,672

Number of record holders of American Depositary Receipts as of 26 January 2005:

> In the US	2,877
> Total	2,907

So far as the Company is aware, it is neither directly nor indirectly owned nor controlled by one or more corporations or by any government.

As of 26 January 2005, the total amount of the Company's voting securities owned by Directors and Officers of the Company was:

<b>Title of class</b>	<b>Amount owned (\$0.25 shares)</b>	<b>Percent of class</b>
Ordinary Shares	394,632	0.02%

The Company does not know of any arrangements, the operation of which might result in a change in the control of the Company.

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## Shareholder Information continued

### Related party transactions

During the period 1 January 2005 to 26 January 2005, there were no transactions, loans, or proposed transactions between the Company and any related parties which were material to either the Company or the related party, or which were unusual in their nature or conditions. (See also Note 32).

### Options to purchase securities from registrant or subsidiaries

(a) At 26 January 2005, options outstanding to subscribe for Ordinary Shares of \$0.25 of the Company were:

Number of shares	Subscription price	Normal expiry date
55,518,810	891p 3487p	2005 2014

The weighted average subscription price of options outstanding at 26 January 2005 was 2714p. All options were granted under Company employee schemes.

(b) Included in paragraph (a) are options granted to Directors and Officers of AstraZeneca as follows:

Number of shares	Subscription price	Normal expiry date
2,253,693	891p 3487p	2005 2014

(c) Included in paragraph (b) are options granted to individually named Directors. Details of these option holdings at 31 December 2004 are shown in the Directors' Remuneration Report.

During the period 1 January 2005 to 26 January 2005, no Director exercised any options. On 14 January 2005, Håkan Mogren ceased to have an interest in an option over 6,462 Ordinary Shares on the expiry of the option.

### Dividend payments

The record date for the second interim dividend for 2004, payable on 21 March 2005 (in the UK, the US and Sweden), is 11 February 2005. Shares trade ex-dividend on the London and Stockholm Stock Exchanges from 9 February 2005 and ADRs trade ex-dividend on the New York Stock Exchange from the same date. From 2005, dividends will normally be paid as follows:

First interim: Announced end of July and paid in September.  
Second interim: Announced end of January and paid in March.

The record date for the first interim dividend for 2005, payable on 19 September 2005 (in the UK, the US and Sweden), is 12 August 2005.

### Shareview

AstraZeneca's shareholders with internet access may visit [shareview.co.uk](http://shareview.co.uk) and register their details to create a portfolio. Shareview is a free and secure on-line service from Lloyds TSB Registrars that gives access to shareholdings including balance movements, indicative share prices and information about recent dividends.

**ShareGift**

AstraZeneca welcomes and values all its shareholders, no matter how many or how few shares they own. However, shareholders who have only a small number of shares whose value makes it uneconomic to sell them, either now or at some stage in the future, may wish to consider donating them to charity through ShareGift, an independent charity share donation scheme. One feature of the scheme is that there is no gain or loss for capital gains tax purposes on gifts of shares through ShareGift and it may now also be possible to obtain income tax relief on the donation. Further information about ShareGift can be found on its website, [sharegift.org](http://sharegift.org), or by contacting ShareGift on 020 7337 0501 or at 46 Grosvenor Street, London W1K 3HN. More information about the tax position on gifts of shares to ShareGift can be obtained from the Inland Revenue whose website address is [inlandrevenue.gov.uk](http://inlandrevenue.gov.uk). The share transfer form needed to make a donation may be obtained from the AstraZeneca Registrar, Lloyds TSB Registrars whose address can be found on the back cover of this document. ShareGift is administered by The Orr Mackintosh Foundation, registered charity number 1052686.

**The Unclaimed Assets Register**

AstraZeneca supplies unclaimed dividend data to the Unclaimed Assets Register (UAR) which provides investors who have lost track of shareholdings with an opportunity to search the UAR's database of unclaimed financial assets on payment of a small, fixed fee. The UAR donates part of the search fee to charity. The UAR can be contacted at Leconfield House, Curzon Street, London W1J 5JA and at [uar.co.uk](http://uar.co.uk).

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**Results**

Unaudited trading results of AstraZeneca in respect of the first three months of 2005 will be published on 28 April 2005 and results in respect of the first six months of 2005 will be published on 28 July 2005.

**Documents on display**

The Memorandum and Articles of Association of the Company and other documents concerning the Company which are referred to in this document may be inspected at the Company's registered office at 15 Stanhope Gate, London W1K 1LN.

**Taxation for US residents**

The following summary of the material UK and certain US tax consequences of ownership of Ordinary Shares or ADRs held as capital assets by US resident shareholders is based on current UK and US federal income tax law, including the new US/UK double taxation convention relating to income and capital gains, which entered into force on 31 March 2003 (the *Convention*) and the prior US/UK double taxation convention relating to income and capital gains (the *Prior Convention*), and practice. This discussion is also based in part on representations of JPMorgan Chase Bank as Depositary for ADRs and assumes that each obligation in the deposit agreement among the Company, the Depositary and the holders from time to time of ADRs and any related agreements will be performed in accordance with their terms. The US Treasury has expressed concerns that parties to whom ADRs are pre-released may be taking actions that are inconsistent with the claiming, by US holders of ADRs, of foreign tax credits for US federal income tax purposes. Such actions could also be inconsistent with the claiming of the reduced tax rate, described below, applicable to dividends received by certain non-corporate US resident shareholders. Accordingly, the analysis of the creditability of UK taxes and the availability of the reduced tax rate for dividends received by certain non-corporate US resident shareholders both as described below, could be affected by future actions that may be taken by parties to whom ADRs are pre-released.

**UK and US income taxes and tax treaties affecting remittance of dividends**

Under the *Prior Convention*, US resident individuals who were the beneficial owners of dividends on Ordinary Shares, or ADRs representing Ordinary Shares, in UK corporations were generally entitled to a tax credit payment in respect of dividends equal to one-ninth (1/9th) of the dividend paid (the *Tax Credit Amount*). This tax credit payment was reduced by a UK withholding (the *UK withholding*) of up to 15% of the gross dividend paid. Therefore, a US holder would not actually receive any payment of this credit.

US resident corporate shareholders are generally treated in the same way as individuals provided that either alone, or together with associated corporations, they do not control directly or indirectly 10% or more of the voting shares of the Company and do not constitute investment or holding companies, 25% or more of the capital of which is owned, directly or indirectly, by persons that are not individuals resident in, and are not nationals of, the US.

Under the *Convention*, US resident shareholders are no longer entitled to the *Tax Credit Amount* because the *Convention* does not provide for that entitlement. The *Convention* applies to dividend payments after 1 May 2003. However, if a US resident shareholder would have been entitled to greater benefits under the *Prior Convention*, the US resident shareholder may elect to continue to apply the *Prior Convention* until 1 May 2004.

For US federal income tax purposes, the dividend paid and, if a US resident shareholder elects under the *Prior Convention* to claim a foreign tax credit with respect to the *UK withholding*, the associated *Tax Credit Amount* are includible in gross income by US resident shareholders and, for foreign tax credit limitation purposes, are foreign source income. The *UK withholding* is treated as a foreign income tax which may, subject to certain limitations and restrictions, be eligible for credit against a US resident shareholder's US federal income tax liability (or deductible by such shareholders in computing their taxable income) for a US resident shareholder who elects to include the associated *Tax Credit Amount* in income.

Subject to applicable limitations, dividends received by certain US resident non-corporate holders of Ordinary Shares or ADRs in taxable years beginning before 1 January 2009 may be subject to US federal income tax at a maximum rate of 15%. US resident shareholders should consult their own tax advisors to determine whether they are subject to any special rules which may not limit



their ability to be taxed at this favourable rate.

**Taxation on capital gains**

Under the Convention each contracting state may in general tax capital gains in accordance with the provisions of its domestic law. Under present UK law, individuals who are neither resident nor ordinarily resident in the UK, and companies which are not resident in the UK will not be liable to UK tax on capital gains made on the disposal of their Ordinary Shares or ADRs, unless such Ordinary Shares or ADRs are held in connection with a trade, profession or vocation carried on in the UK through a branch or agency.

A US resident shareholder will recognise capital gain or loss for US federal income tax purposes on the sale or exchange of Ordinary Shares or ADRs in the same manner as such a holder would on the sale or exchange of any other shares held as capital assets. As a result, a US resident shareholder will generally recognise capital gain or loss for US federal income tax purposes equal to the difference between the amount realised and such holder's adjusted basis in the Ordinary Shares or ADRs. The gain or loss will generally be US source income or loss. US resident shareholders should consult their own tax advisors about the treatment of capital gains, which may be taxed at lower rates than ordinary income for non-corporate taxpayers and capital losses, the deductibility of which may be limited.

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## Shareholder Information continued

### UK inheritance tax

Under the current Double Taxation (Estates) Convention (the Estate Tax Convention) between the US and the UK, Ordinary Shares or ADRs held by an individual shareholder who is domiciled for the purposes of the Estate Tax Convention in the US, and is not for the purposes of the Estate Tax Convention a national of the UK, will generally not be subject to UK inheritance tax on the individual's death or on a chargeable gift of the Ordinary Shares or ADRs during the individual's lifetime, provided that any applicable US federal gift or estate tax liability is paid, unless the Ordinary Shares or ADRs are part of the business property of a permanent establishment of the individual in the UK or, in the case of a shareholder who performs independent personal services, pertain to a fixed base situated in the UK. Where the ADRs or Ordinary Shares have been placed in trust by a settlor who, at the time of settlement, was a US resident shareholder, the ADRs or Ordinary Shares will generally not be subject to UK inheritance tax unless the settlor, at the time of settlement, was not domiciled in the US and was a UK national. In the exceptional case where the Ordinary Shares or ADRs are subject both to UK inheritance tax and US federal gift or estate tax, the Estate Tax Convention generally provides for double taxation to be relieved by means of credit relief.

### Exchange controls and other limitations affecting security holders

- (a) There are no governmental laws, decrees or regulations in the UK restricting the import or export of capital or affecting the remittance of dividends, interest or other payments to non-resident holders of Ordinary Shares or ADRs. However, a 1.5% stamp duty reserve tax is payable upon the deposit of Ordinary Shares in connection with the creation of, but not subsequent dealing in, ADRs. This is in lieu of the normal 0.5% stamp duty on all purchases of Ordinary Shares.
- (b) There are no limitations under English law or the Company's Memorandum and Articles of Association on the right of non-resident or foreign owners to be the registered holders of and to vote Ordinary Shares or to be registered holders of notes or debentures of Zeneca Wilmington Inc. or AstraZeneca PLC.

### Exchange rates

For the periods up to April 1999, Astra accounted for and reported its results in Swedish kronor, whereas Zeneca accounted for and reported its results in sterling. Consistent with AstraZeneca's decision to publish its Financial Statements in US dollars, the financial information in this document has been translated from kronor and sterling into US dollars at the following applicable exchange rates:

	SEK/USD	USD/GBP
Average rates (profit and loss account, cash flow)		
1995	7.1100	1.5796
1996	6.7000	1.5525
1997	7.6225	1.6386
1998	7.9384	1.6603
1999	8.2189	1.6247
End of year spot rates (balance sheet)		
1995	6.6500	1.5500
1996	6.8400	1.6900

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1997	7.8500	1.6600
1998	8.0400	1.6600
1999	8.5130	1.6185

The following information relating to average and spot exchange rates used by AstraZeneca is provided for convenience:

	SEK/USD	USD/GBP
Average rates (profit and loss account, cash flow)		
2002	9.8558	1.4817
2003	8.3013	1.6233
2004	7.4613	1.8031
End of year spot rates (balance sheet)		
2002	8.7700	1.6093
2003	7.1932	1.7815
2004	6.6144	1.9264

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**Definitions**

In this Annual Report and Form 20-F Information the following words and expressions shall, unless the context otherwise requires, have the following meanings:

ADR	American Depositary Receipt evidencing title to an ADS
ADS	American Depositary Share representing one underlying Ordinary Share
Depositary	JPMorgan Chase Bank, as depositary under the deposit agreement pursuant to which the ADRs are issued
Directors	The Directors of the Company
Company	AstraZeneca PLC
AstraZeneca, AstraZeneca Group or the Group	The Company and its subsidiaries
Ordinary Shares	Ordinary Shares of \$0.25 each in the capital of the Company
LSE	London Stock Exchange Limited
NYSE	New York Stock Exchange, Inc.
SSE	Stockholm Stock Exchange
Sterling, £, GBP, pence or p	References to UK currency
SEK, kronor, krona	References to Swedish currency
UK	United Kingdom of Great Britain and Northern Ireland
US dollar, US\$, USD or \$	References to US currency
US	United States of America

Figures in parentheses in tables and financial statements are used to represent negative numbers.

Except where otherwise indicated, figures included in this report relating to pharmaceutical product market sizes and market shares are obtained from syndicated industry sources, primarily IMS Health (IMS), a market research firm internationally recognised by the pharmaceutical industry. The 2004 market share figures included in this report are based primarily on data obtained from an online IMS database.

IMS data may differ from that compiled by the Group with respect to its own products. Of particular significance in this regard are the following: (1) AstraZeneca publishes its financial results on a financial year and quarterly interim basis, whereas IMS issues its data on a monthly and quarterly basis; (2) the online IMS database is updated quarterly and uses the average exchange rates for the relevant quarter; (3) IMS data from the US is not adjusted for Medicaid and similar state rebates; and (4) IMS sales data are compiled using actual wholesaler data and data from statistically representative panels of retail and hospital pharmacies, which data are then projected by IMS to give figures for national markets.

References to prevalence of disease have been derived from a variety of sources and are not intended to be indicative of the current market or any potential market for AstraZeneca's pharmaceutical products since, among other things, there may be no correlation between the prevalence of a disease and the number of individuals who are treated for such a disease.

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Shareholder Information

## Shareholder Information continued

### Terms used in the Annual Report and Form 20-F Information

Terms used in the Annual Report and Form 20-F Information	US equivalent or brief description
Accruals	Accrued expenses
Allotted	Issued
Bank borrowings	Payable to banks
Called-up share capital	Issued share capital
Capital allowances	Tax term equivalent to US tax depreciation allowances
Creditors	Liabilities/payables
Current instalments of loans	Long term debt due within one year
Debtors	Receivables and prepaid expenses
Earnings	Net income
Finance lease	Capital lease
Fixed asset investments	Non-current investments
Freehold	Ownership with absolute rights in perpetuity
Interest receivable	Interest income
Interest payable	Interest expense
Loans	Long term debt
Prepayments	Prepaid expenses
Profit	Income
Profit and loss account	Income statement/consolidated statement of income
Reserves	Retained earnings
Short term investments	Redeemable securities and short term deposits
Share premium account	Premiums paid in excess of par value of Ordinary Shares
Statement of total recognised gains and losses	Statement of comprehensive income

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Stocks	Inventories
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Tangible fixed assets	Property, plant and equipment
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Turnover	Sales/revenues
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## Risk Factors

### **Risk of loss or expiration of patents, marketing exclusivity or trade marks**

Scientific development and technological innovation are crucial if AstraZeneca is to deliver long term market success. In the pharmaceutical market, a drug, diagnostic or medical device is normally only subject to competition from alternative products, in the same therapy area, during the period of patent protection or other types of marketing exclusivity, but once patent protection or other types of marketing exclusivity have expired the product is generally open to competition from generic copy products. Products under patent protection or other types of marketing exclusivity usually generate significantly higher revenues than those not protected by patents or other types of marketing exclusivity. We believe that we have patent protection for many of our most important products.

For example, during 2004 compared to 2003, sales in the US of

*Lossec/Prilosec*, *Zestril* and *Nolvadex* fell significantly following anticipated patent expiries or the end of marketing exclusivity.

Increasingly, manufacturers of generic pharmaceutical products, whether based in developing countries, such as those in Asia, or elsewhere in the world, seek to challenge our patents or other types of marketing exclusivity in order to allow access to the market for their own generic products.

For example, AstraZeneca was involved in litigation in the US and elsewhere during 2004 relating to omeprazole, the active ingredient in *Lossec/Prilosec*, concerning the infringement of certain patents, including formulation patents, by generic manufacturers. Patent litigation

marketing exclusivity, products protected by a valid trade mark usually generate higher revenues than those not protected by a trade mark. We believe that we have trade mark protection for many of our most important products. However, trade mark protection may expire or be challenged by third parties.

Limitations on the availability of patent protection in developing countries or the expiration or loss of certain patents, marketing exclusivity or trade marks would have an adverse effect on pricing and sales with respect to these products and, consequently, could result in a material adverse effect on AstraZeneca's financial condition and results of operations.

### **Impact of fluctuations in exchange rates**

The results of AstraZeneca's operations are accounted for in US dollars. Approximately 49% of our 2004 sales were in North America (comprised of the US and Canada) with a significant proportion of that figure being in respect of US sales. The US is, and is expected to remain, our largest market. Sales in certain other countries are also in US dollars, or in currencies whose exchange rates are linked to the US dollar. Major components of our cost base are, however, located in Europe, where an aggregate of approximately 60% of our employees are based. Movements in the exchange rates used to translate foreign currencies into US dollars may therefore have a material adverse effect on AstraZeneca's financial condition and results of operations.

Certain subsidiaries of AstraZeneca import and export goods and services in currencies other than their own functional currency, although we minimise this practice. The results of

weakening of the US dollar is generally favourable. We cannot ensure that exchange rate fluctuations will not have a material adverse effect on AstraZeneca's financial condition and results of operations in the future.

### **Risk that R&D will not yield new products that achieve commercial success**

As a result of the complexities and uncertainties associated with pharmaceutical research, it cannot be ensured that compounds currently under development will achieve success in laboratory, animal or clinical trials and ultimately be granted the regulatory approvals needed to market such products successfully. For example, in 2004, development of a number of our products was discontinued due to failure to meet our target profile: these included AZD0303 for the treatment of thrombosis; AZD4750 for the treatment of multiple sclerosis; and AZD0902 for the treatment of chronic obstructive pulmonary disease. There can be no absolute assurances regarding the development and commercial success of any of the products in our current pipeline. The commercial success of pipeline products is of particular importance to us in view of the recent expiry of patent protection in major markets for a number of our key current products.

### **Competition, price controls and price reductions**

The principal markets for our pharmaceutical products are the Americas, the countries of the European Union and Japan. These markets are highly competitive. We compete in all of them, and elsewhere in the world, against major prescription pharmaceutical companies which, in many cases, are able to match or exceed the resources which we have



relating to omeprazole and certain other of our products is described in Note 30 to the Financial Statements.

In addition to challenges to our patented products from manufacturers of generic pharmaceutical products, there is a risk that some countries, particularly those in the developing world, may seek to impose limitations on the availability of patent protection for pharmaceutical products, or the extent to which such protection may be obtained, within their jurisdictions.

Trade mark protection for our products is also an important element of our overall product marketing programmes. Combined with patent protection or other types of

such subsidiaries could, therefore, be affected by currency fluctuations arising between the transaction dates and the settlement dates for those transactions. We hedge these exposures through financial instruments in the form of forward contracts and currency swaps. The notional principal amount of financial instruments used to hedge these exposures, principally forward foreign exchange contracts and purchased currency options, at 31 December 2004 was \$31m. We have policies that seek to mitigate the effect of exchange rate fluctuations on the value of foreign currency cash flows and in turn their effects on the results of the various subsidiaries, but do not seek to remove all such risks. In general, a unilateral strengthening of the US dollar adversely affects our reported results whereas a

available to us, particularly in the areas of R&D and marketing investment. Industry consolidation has resulted in the formation of a small number of very large companies. Some of our most important products for future growth, such as *Crestor*, compete directly with similar products marketed by some of these companies. Increasingly, we also compete directly with biotechnology companies and companies which manufacture generic versions of our products following the expiry or loss of patent protection or other marketing exclusivity.

In most of the principal markets in which we sell our products, there is continued economic, regulatory and political pressure to limit the cost of pharmaceutical products. Certain groups have been involved in

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Risk Factors

## Risk Factors continued

exerting price pressure on pharmaceutical companies to ensure medicines are affordable to those who need them.

Currently there is no direct government control of prices for non-government sales in the US. In 1990, however, federal legislation was enacted which required drug manufacturers to agree to substantial rebates in order for the manufacturer's drugs to be reimbursed by state Medicaid programmes, and an additional rebate if manufacturer price increases after 1990 exceed the increase in inflation. In addition, certain states have taken action to require further manufacturer rebates on Medicaid drug utilisation and for other state pharmaceutical assistance programmes. Congress has also enacted statutes that place a ceiling on the price manufacturers may charge US government agencies, thereby causing a substantial discount, as well as establishing a minimum discount (comparable to the Medicaid rebate) on manufacturers' sales to certain clinics and hospitals that serve the poor and other populations with special needs. These government initiatives, together with competitive market pressures, have contributed to restraints on realised prices.

Recently introduced and future US legislation concerning the Medicaid and Medicare programmes are likely to significantly affect our US business. It is difficult to predict with certainty the actual effect on our business of such changes to the legislation.

In addition, realised prices are being depressed by pressure from managed care and institutional purchasers, who use cost considerations to restrict the sale of preferred drugs that their physicians may prescribe, as well as other competitive activity. Such limited

prices by incentives and sanctions to encourage doctors to prescribe cost-effectively. Efforts by the European Commission to harmonise the disparate national systems have met with little immediate success. The industry is, therefore, exposed to ad hoc national cost-containment measures on prices and the consequent parallel trading of products from markets with prices depressed by governments into those where higher prices prevail.

The importation of pharmaceutical products from European countries where prices are low to those where prices for those products are higher may increase. The accession of additional countries from central and eastern Europe to the European Union could result in significant increases in the parallel trading of pharmaceutical products. Movements of pharmaceutical products into North America, in particular the movement of products from Canada into the US, may increase despite the need to meet current or future safety requirements imposed by regulatory authorities. The effects of any increase in the volume of this parallel trade could result in a material adverse effect on AstraZeneca's financial condition and results of operations.

There is formal central government control of prices in Japan. New product prices are determined primarily by comparison with existing products for the same medical condition. All existing products are subject to a price review at least every two years. Regulations introduced in 2000 included provisions allowing a drug's price to be set according to the average price of the product in four major countries (the US, the UK, Germany and France).

### **Risk of substantial product liability claims**

Given the widespread impact prescription drugs may have on the health of large patient populations, pharmaceutical and medical device companies have, historically, been subject to large product liability damages claims, settlements and awards for injuries allegedly caused by the use of their products. Adverse publicity relating to a product's safety, such as that affecting *Crestor* in 2004, may increase the risk of product liability claims. Substantial product liability claims that are not covered by insurance could have a material adverse effect on AstraZeneca's financial condition and results of operations.

### **Risk of reliance on third parties for supplies of materials and services**

Like most, if not all, major prescription pharmaceutical companies, in some of its key business operations, such as the manufacture, formulation and packaging of products, AstraZeneca relies on third parties for the timely supply of specified raw materials, equipment, contract manufacturing, formulation or packaging services and maintenance services. Although we actively manage these third party relationships to ensure continuity of supplies on time and to our required specifications, some events beyond our control could result in the complete or partial failure of supplies or in supplies not being delivered on time. Any such failure could have a material adverse effect on AstraZeneca's financial condition and results of operations.

### **Risk of delay to new product launches**

AstraZeneca's continued success depends on the development and

lists or formularies may force manufacturers either to reduce prices or be excluded from the list, thereby losing all the sales revenue from patients covered by that formulary. The use of strict formularies by institutional customers is increasing rapidly in response to the current cost-containment environment, resulting in lower margins on such sales.

Some governments in Europe, notably Italy and Spain, set price controls having regard to the medical, economic and social impact of the product. In other European countries, primarily Germany, the UK, the Netherlands and, more recently, France, governments are exerting a strong downward pressure on

#### **Taxation**

The UK is party to various double tax treaties with foreign jurisdictions which enable AstraZeneca's revenues and capital gains to escape a double tax charge to both UK and foreign jurisdiction tax. If any of these double tax treaties should be withdrawn or amended, or should any member of the AstraZeneca Group become involved in taxation disputes with any tax authority, such withdrawal, amendment or a negative outcome of such disputes could have a material adverse effect on AstraZeneca's financial condition and results of operations.

successful launch of innovative new drugs. The anticipated launch dates of major new products have a significant impact on a number of areas of our business, including investment in large clinical trials, the manufacture of pre-launch stocks of the products and the timing of anticipated future revenue streams from commercial sales of the products. Any delay to the anticipated launch dates may therefore impact AstraZeneca's business and operations in a number of ways. For example, we had expected *Crestor* to be launched in the US in the second half of 2002. However, the approval of products in the same class as *Crestor* was subject to additional regulatory scrutiny partly as a result of the previous withdrawal from the market of cerivastatin. *Crestor* was launched in the US in September 2003. Significant delay to the

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anticipated launch dates of new products could have a material adverse effect on AstraZeneca's financial condition and results of operations.

#### **Difficulties of obtaining government regulatory approvals for new products**

AstraZeneca is subject to strict controls on the manufacture, labelling, distribution and marketing of pharmaceutical products. The requirement to obtain regulatory approval based on safety, efficacy and quality before such products may be marketed in a particular country and to maintain and to comply with licences and other regulations relating to their manufacture are particularly important. The submission of an application to a regulatory authority does not guarantee that approval to market the products will be granted. The countries that constitute material markets for our pharmaceutical products include the US, the countries of the European Union and Japan. Approval of such products is required by the relevant regulatory authority in each country, although in Europe, single marketing authorisation can govern the approval of products throughout the European Union through a centralised procedure. In addition, each jurisdiction has very high standards of regulatory approval and, consequently, in most cases, a lengthy approval process. Furthermore, each regulatory authority may impose its own requirements and may refuse to grant, or may require additional data before granting an approval even though the relevant product has been approved in another country. For example, in 2004 the FDA did not approve *Exanta* for any of the indications sought and although the Japanese regulatory authority granted approval for *Crestor*, this was conditional on a post-marketing surveillance programme being carried out.

following a failure to comply with such ongoing regulatory oversight, could have a material adverse effect on AstraZeneca's financial condition and results of operations.

#### **Performance of new products**

Although we carry out numerous and extensive clinical trials on all our products before they are launched, for a new, recently launched product, it can be difficult, for a period following its launch, to establish from available data a meaningful and reliable assessment of its eventual efficacy and/or safety in clinical use on the market. Due to the relatively short time that a product has been marketed and the relatively small number of patients who have taken the product, the available data may be immature. Simple extrapolation of the data may not be accurate and could lead to a misleading interpretation of a new product's likely future commercial performance.

The successful launch of a new pharmaceutical product involves a substantial investment in sales and marketing costs, launch stocks and other items. If a new product does not succeed as anticipated or its rate of sales growth is slower than anticipated, there is a risk that the costs incurred in launching it could have a material adverse effect on AstraZeneca's financial condition and results of operations.

#### **Environmental liabilities**

AstraZeneca has environmental liabilities at some currently or formerly owned, leased and third party sites in the US, as described in more detail on page 111. There is no reason for us to believe that current and expected expenditure and risks occasioned by these circumstances are likely to have a material adverse effect on AstraZeneca's financial position and results of operations although they

could have a material adverse effect on AstraZeneca's financial position and results of operations.

#### **Risks associated with forward-looking statements**

This report contains certain forward-looking statements about AstraZeneca. Although we believe our expectations are based on reasonable assumptions, any forward-looking statements may be influenced by factors that could cause actual outcomes and results to be materially different from those predicted. Forward-looking statements are identified in this report, by using the words *anticipates*, *believes*, *expects*, *intends* and similar expressions. These forward-looking statements are subject to numerous risks and uncertainties. Important factors that could cause actual results to differ materially from those in forward-looking statements, certain of which are beyond our control, include, among other things: the loss or expiration of patents, marketing exclusivity or trade marks; exchange rate fluctuations; the risk that R&D will not yield new products that achieve commercial success; the impact of competition, price controls and price reductions; taxation risks; the risk of substantial product liability claims; the impact of any failure by third parties to supply materials or services; the risk of delay to new product launches; the difficulties of obtaining and maintaining governmental approvals for products; and the risk of environmental liabilities.

**Risk of failure to observe ongoing regulatory oversight**

AstraZeneca's products are only licensed following exhaustive regulatory approval processes. Once a product is licensed it is subject to ongoing control and regulation, such as the manner of its manufacture, distribution and marketing. Regulatory authorities have wide-ranging administrative powers to deal with any failure to comply with their ongoing regulatory oversight. These powers include withdrawal of a licence approval previously granted, product recalls, seizure of products and other sanctions for non-compliance. Regulatory sanction,

could, to the extent that they exceed applicable provisions, have a material adverse effect on AstraZeneca's financial position and results of operations for the relevant period. In addition, a change in circumstances (including a change in applicable laws or regulations) may result in such a material adverse effect. Although we take great care to ensure that we operate our business at all of our sites within all applicable environmental laws, regulations, licences and permits, a significant environmental incident for which we were responsible could result in AstraZeneca being liable to pay compensation, fines or remediation costs. In some circumstances, such liability

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AstraZeneca Code of Conduct

## AstraZeneca Code of Conduct

### Introduction

We are committed to dealing with all our stakeholders with the highest ethical standards, integrity and as responsible corporate citizens. The trust and confidence of all our stakeholders, together with our reputation, are among the most valuable assets of the Group. Along with our commitment to competitiveness and performance, we will continue to be led by our values to achieve sustainable success.

Every AstraZeneca employee is required to make a personal commitment to follow the Company's Code of Conduct, as well as the detailed standards issued in support of it, and uphold our commitment to our values, integrity and corporate responsibility.

We are all privileged to work for one of the best companies in the world and must ensure we leave a lasting legacy. Nothing—not the need to meet targets, or direct orders from a superior—should ever compromise our commitment to honesty and integrity.

### Sir Tom McKillop Chief Executive

#### Policy

AstraZeneca requires its companies, and their employees, to observe the highest standards of integrity and honesty and act with due skill, care, diligence and fairness in the conduct of business. To this end all AstraZeneca Companies, and their employees, are required to comply with the laws of all countries in which they operate and with the high ethical standards detailed by AstraZeneca in support of this policy.

#### Compliance

It is the responsibility of management to ensure that the AstraZeneca Code of

situation that may confront employees in markets around the world. In appropriate cases, guidance on the application of the Code to particular situations should be sought from management. In addition, Legal Department and Group Internal Audit are available on a confidential basis as independent sources of advice.

It is the responsibility of each employee to report promptly any violations of the Code of Conduct of which they become aware. AstraZeneca assures individual employees who raise issues that they will be protected from any adverse impact on their employment as a result. AstraZeneca actively encourages employees to raise issues of concern.

### Standards of Conduct Business practices

AstraZeneca Companies, and their employees, must comply with the laws of all countries in which they operate, with appropriate international and national industry codes of practice and with the high ethical standards specified by AstraZeneca.

It is the responsibility of all employees to ensure, by taking advice where appropriate, that they are fully aware of all relevant laws, regulations, practices and codes of practice, particularly as they relate to their job.

Employees should ensure that, within their sphere of business activity, AstraZeneca Companies carry out their contractual obligations in a proper and timely manner and are not in breach of contract.

Business practice, and what amounts to improper conduct, varies from country to country and from industry to industry. All employees will comply with (a) the high ethical standards specified by

No employee should seek or accept a gift, entertainment or personal favour which might reasonably be believed to have any influence on business transactions. An offer of entertainment should not be accepted unless the offer is within the bounds of accepted business hospitality. Gifts which do not meet the above criteria should be reported to management who shall determine how they shall be dealt with.

AstraZeneca funds will not be used in payments, direct or indirect, to government officials, people participating in government bodies, employees of state organisations or representatives of political parties, for unlawful or improper purposes.

### Equal opportunities

All employees shall be treated with equal respect and dignity and shall be provided with equality of opportunity to develop themselves and their careers.

AstraZeneca is striving to achieve diversity at all levels of the organisation and values the individuality, diversity and creative potential that every employee brings to its business and supports the continuous development of their skills and abilities.

Judgements about people for the purpose of recruitment, development or promotion shall be made solely on the basis of a person's ability and potential in relation to the needs of the job and shall only take account of matters relevant to the performance of that job. Overall, success and advancement within AstraZeneca shall depend solely on personal ability, behaviour and work performance.

In some countries these principles may be modified by national legal requirements for affirmative action.

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Conduct and standards are communicated, understood and acted upon. They are required to positively promote them by personal example and are not entitled to permit any exceptions to the required behaviour.

All employees should familiarise themselves with the Code of Conduct and must comply with it. Failure to act in compliance with the Code will result in appropriate disciplinary action against both the employee committing the breach and others who condone it.

The Standards set out in the Code are general and do not address each and every

AstraZeneca (b) any published overall AstraZeneca Code relating to business practices and (c) any international and national codes of practice applicable to the conduct of business in each environment.

Gifts, entertainment and personal favours may only be offered to a third party if modest in value and if they are consistent with customary business practice. No gifts, entertainment or personal favour may be offered in contravention of any applicable law or code of practice.

### **Personal harassment**

Personal harassment, such as verbal abuse or sexual harassment, of any employee of AstraZeneca, its suppliers or customers is unacceptable in any form whatsoever.

Any person who believes they have been personally harassed should report the incident and circumstances to their immediate manager or HR manager or other senior manager who will arrange for it to be investigated impartially and confidentially. AstraZeneca is fully supportive of the principles set forth in the UN Declaration of Human Rights. These include freedom from

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torture and arbitrary arrest, the right to a fair trial and equality before the law.

**Political contributions**

Any political contributions by AstraZeneca Companies must be lawful and approved under procedures laid down by the board or governing body of the Company concerned.

Approval should not be given to any political contributions by AstraZeneca Companies which, by their scale or affiliation, might be seen as excessive or inappropriate. AstraZeneca's accounting procedures require any political contribution to be reported to AstraZeneca headquarters as part of the annual consolidation of results.

**Conflicts of interest**

Employees dealing with AstraZeneca's business must act in the best interests of AstraZeneca and must disregard any personal preference or advantage.

Employees should avoid entering into situations in which their personal, family or financial interests may conflict with those of AstraZeneca. Where any potential conflict of interest may arise, the employee shall declare that interest and seek advice from senior management.

Examples of conflict to be declared and resolved include:

- > having a family interest in a transaction with AstraZeneca or one of its subsidiaries (the Company) or any supplier or customer;
- > hiring of a family member in any capacity;
- > having an interest, directly or through family, in a competitor, supplier or customer of the Company;
- > having an interest, directly or through family, in an organisation that has, or seeks to do business with the Company;
- > acquiring an interest in property (such as real estate, patent rights or securities) where the Company has, or might have, an interest.

These examples do not extend to normal and proper financial investments in publicly quoted companies.

**Insider information**

Employees must not use confidential information obtained through their employment for personal gain.

It is AstraZeneca policy, and in certain countries a legal requirement carrying criminal sanctions, that employees in possession of confidential price sensitive information (in relation to securities) do not make use of such information to deal in securities of AstraZeneca or provide such information to third parties for that purpose. The same considerations apply in relation to confidential price sensitive information relating to other companies and dealing in their securities.

**Property and resources**

AstraZeneca resources should be kept securely and should only be used for the proper advancement of its business and not for personal gain.

Individuals expending AstraZeneca resources should recognise that they owe a duty of care to the shareholders of AstraZeneca, who are its ultimate owners. Commitments and expenditure should only be such as could be justified to shareholders if the facts



were known. This includes any expenses claimed and purchases made for which reimbursement is sought.

AstraZeneca resources include not only tangible assets such as materials, equipment and cash, but also intangible assets such as computer systems, trade secrets and confidential information. Employees should observe global and local guidelines concerning the classifying and handling of documents and electronic data. The storage of personal data in an electronic medium may be governed by laws with which relevant employees should familiarise themselves and comply.

Information generated within AstraZeneca, including research and development and manufacturing data, costs, prices, sales, profits, markets, customers and methods of doing business, is the property of AstraZeneca and must not, unless legally required, be disclosed outside AstraZeneca without proper authority.

**Policies, delegated authorities and reserved powers**

AstraZeneca employees are expected to make themselves aware of and comply with the letter and spirit of all AstraZeneca policies and with the reserved powers and delegated authorities established by the Board from time to time. Copies of these are available on the Company's intranet site(s).

The freedoms which individuals have to carry out their jobs must be exercised within both the letter and spirit of AstraZeneca policies and procedures, reserved powers and delegated authorities. These are designed to empower people to carry out their responsibilities within a necessary framework of corporate control and legal responsibility but are not so voluminous as to prescribe appropriate action in every circumstance.

**Records, disclosures and communications**

AstraZeneca PLC and all AstraZeneca Companies and their employees are required to keep proper accounting and other records which give a true and fair view of the financial position, results of operations, transactions, assets and liabilities so as to enable the Company to make full, fair, accurate, timely and understandable disclosures in all reports it is required to publish, file or submit to shareholders and regulators and in all other communications which it publishes.

All accounting and other records will be maintained in a manner that describes and documents accurately the Company's true financial position and results of operations and the true nature of its business transactions, assets and liabilities. Accounting records will be kept in accordance with AstraZeneca policies, relevant accounting standards and appropriate generally accepted accounting principles.

Employees must ensure that all reports published, filed or submitted to shareholders and regulators and all other communications which are published by the Company are full, fair, accurate, timely and understandable; they must not mislead the reader in any way or omit anything necessary to make them full, fair and accurate. The Chief Executive and the Company's senior financial officers have a particular responsibility in this regard.

**July 2003**

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Additional Information

## Additional Information

### History and development of the Company

AstraZeneca PLC was incorporated in England and Wales on 17 June 1992 under the Companies Act 1985. It is a public limited company domiciled in the UK. The Company's registered number is 2723534 and its registered office is at 15 Stanhope Gate, London W1K 1LN (telephone + 44 (0)20 7304 5000). From February 1993 until April 1999, the Company was called Zeneca Group PLC. On 6 April 1999, the Company changed its name to AstraZeneca PLC.

The Company was formed when the pharmaceutical, agrochemical and specialty chemical businesses of Imperial Chemical Industries PLC were demerged in 1993. In 1999, the Company sold the specialty chemical business. Also in 1999, the Company merged with Astra AB of Sweden. In 2000, it demerged the agrochemical business and merged it with the similar agribusiness of Novartis AG to form a new company called Syngenta AG.

The Company owns and operates numerous R&D, production and marketing facilities worldwide. Its corporate headquarters are at 15 Stanhope Gate, London W1K 1LN and its R&D headquarters are at SE-151 85 Södertälje, Sweden.

### Memorandum and Articles of Association

#### Objects

As is typical of companies registered in England and Wales, the Company's objects, which are detailed in the Memorandum of Association, are broad and wide-ranging and include manufacturing, distributing and trading pharmaceutical products.

#### Directors

Subject to certain exceptions, Directors do not have power to vote at Board Meetings on matters in which they have a material interest.

The quorum for meetings of the Board of Directors is a majority of the full Board, of whom at least four must be Non-Executive Directors. In the absence of a quorum, the Directors do not have power to determine compensation arrangements for themselves or any member of the Board.

The Board of Directors may exercise all the powers of the Company to borrow money. Variation of these borrowing powers would require the passing of a special resolution of the Company's shareholders.

Directors are not required to retire at a particular age.

Directors are required to beneficially own Ordinary Shares in the Company of an aggregate nominal amount of \$125. At present, this means they must own at least 500 shares.

### Rights, preferences and restrictions attaching to shares

The share capital of the Company is divided into 2,400,000,000 Ordinary Shares with a nominal value of \$0.25 each and 50,000 Redeemable Preference Shares with a nominal value of £1.00 each. The rights and restrictions attaching to the Redeemable Preference Shares differ from those attaching to Ordinary Shares as follows:

- > the Redeemable Preference Shares carry no rights to receive dividends;
- > the holders of Redeemable Preference Shares have no rights to receive notices of, attend or vote at general meetings except in certain limited circumstances; they have one vote for every 50,000 Redeemable Preference Shares held;
- >

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on a distribution of assets of the Company, on a winding-up or other return of capital (subject to certain exceptions), the holders of Redeemable Preference Shares have priority over the holders of Ordinary Shares to receive the capital paid up on those shares; and

- > subject to the provisions of the Companies Act 1985, the Company has the right to redeem the Redeemable Preference Shares at any time on giving not less than seven days' written notice.

### **Action necessary to change the rights of shareholders**

In order to vary the rights attached to any class of shares, the consent in writing of the holders of three quarters in nominal value of the issued shares of that class or the sanction of an extraordinary resolution passed at a general meeting of such holders is required.

### **Annual general meetings and extraordinary general meetings**

Annual general meetings and extraordinary general meetings where a special resolution is to be passed or a Director is to be appointed require 21 clear days' notice to

shareholders. All other extraordinary general meetings require 14 clear days' notice.

For all general meetings, a quorum of two shareholders present in person or by proxy is required.

Shareholders and their duly appointed proxies and corporate representatives are entitled to be admitted to general meetings.

### **Limitations on the rights to own shares**

There are no limitations on the rights to own shares.

Designed by Addison Corporate Marketing Ltd

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## Cross Reference to Form 20-F

The information in this document that is referenced on this page is included in AstraZeneca's Form 20-F for 2004 (2004 Form 20-F) and is filed with the Securities and Exchange Commission (SEC). The 2004 Form 20-F is the only document intended to be incorporated by reference into any filings by AstraZeneca under the Securities Act of 1933, as amended. References to major headings include all information under such major headings, including subheadings. References to subheadings include only the information contained under such subheadings. Graphs are not included unless specifically identified. The 2004 Form 20-F has not been approved or disapproved by the SEC nor has the SEC passed comment upon the accuracy or adequacy of the 2004 Form 20-F. The 2004 Form 20-F filed with the SEC may contain modified information and may be updated from time to time.

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