



Their will.
Our medicines.

Together we can prevail.

2006 Annual Report



Bristol-Myers Squibb

Bristol-Myers Squibb's Mission

Our company's mission is to extend and enhance human life by providing the highest-quality pharmaceutical and related health care products.

We pledge—to our patients and customers, to our employees and partners, to our shareholders and neighbors, and to the world we serve—to act on our belief that the priceless ingredient of every product is the honor and integrity of its maker.

ON THE COVER:

At Bristol-Myers Squibb, we develop medicines and related health care products to help people live full and active lives. A few of our patients and customers are pictured on the cover. These and other patients are profiled in our Special Report, beginning on page 7.

To Our Stockholders

2006 was a challenging transitional year for Bristol-Myers Squibb. We experienced the significant negative impact of generic competition in our pharmaceutical business, and made the difficult decision to change leadership of the company. We also achieved preliminary settlement of an investigation of drug pricing, sales and marketing practices that began many years ago. At the same time, we were successful in launching several promising new products, expanding key businesses and advancing our robust pipeline—all in areas of serious unmet medical need. As a result, Bristol-Myers Squibb is now well positioned to begin growing sales and earnings, and to build shareholder value.

FINANCIAL PERFORMANCE

In 2006, the company's net earnings from continuing operations on a GAAP (Generally Accepted Accounting Principles) basis were \$1.6 billion, or \$0.81 per diluted share, from net sales from continuing operations of \$17.9 billion. This compares to earnings of \$3.0 billion, or \$1.52 per diluted share, on sales of \$19.2 billion in 2005. On a non-GAAP basis, excluding specified items, net earnings from continuing operations in 2006 were \$2.1 billion, or \$1.09 per diluted share, compared to \$2.8 billion, or \$1.43 per diluted share, in 2005.

Sales and earnings were adversely affected by several developments in the year. First, as expected, we lost exclusivity on *Pravachol*, our cholesterol-lowering medicine, in the U.S. and in several European countries. For many years, *Pravachol* was one of our leading products. More recently, we experienced the negative impact of generic competition with our top-selling product Plavix (clopidogrel bisulfate), an antiplatelet medicine that Bristol-Myers Squibb and sanofi-aventis (Sanofi) are codeveloping and co-commercializing around the world.

In August 2006, the Canadian pharmaceutical company Apotex launched its generic version of Plavix in the U.S., flooding the market for several weeks until sales were halted by a court order. This action by Apotex reduced our Plavix sales in the range of \$1.2 billion to \$1.4 billion in 2006, and was reflected in an overall 15 percent decline in Plavix sales for the year. We expect the generic supply in the market will have a residual impact on 2007 Plavix sales.

PLAVIX SITUATION

Several years ago, Apotex filed a request with the U.S. Food and Drug Administration (FDA) to sell its generic clopidogrel product in the U.S., despite the existence of patents on Plavix held by Sanofi and Bristol-Myers Squibb in the U.S. and other countries. Believing our patents to be valid and infringed, we sued Apotex to protect our valuable intellectual property rights. Bristol-Myers Squibb and Sanofi had invested extensively in Plavix over more than a decade to conduct clinical research demonstrating its benefits to patients.

Because of the way U.S. law in this area is structured, Apotex was able to apply for and receive permission to market its generic clopidogrel in the U.S., even though the dispute over the validity of the Plavix patent had not yet been settled. In early 2006, the FDA approved Apotex's request, enabling that company to launch its generic product in the U.S., although this action could put it at risk of legal sanctions.

With these concerns in mind, the parties to the dispute entered into discussions and in March 2006 announced a tentative settlement of the patent infringement litigation. However, the government did not approve the proposed settlement, and in July we announced that the patent infringement litigation would resume. Shortly thereafter, Apotex launched its generic clopidogrel in the U.S. We responded by seeking a preliminary injunction from a Federal court to halt its further distribution. The court granted the preliminary injunction on August 31, and it remains in force.

Clearly, our Plavix business—and the company's financial strength and reputation—were seriously damaged by this turn of events. It was a major setback that we sincerely regret. Bristol-Myers Squibb and Sanofi had entered into negotiations with Apotex in good faith to pursue a workable solution benefiting all parties.

The Plavix patent trial concluded on February 15 of this year, and the court is expected to rule in the next few months. We are hopeful that the validity of our intellectual property rights will be upheld. In the meantime, we are encouraged that demand for Plavix continues to grow, pointing to a positive future for this therapy in helping even more patients. And we continue to invest behind the brand.

PRODUCT HIGHLIGHTS

In 2006, we launched several noteworthy pharmaceutical products:

- *Orencia* is a promising new treatment option for many patients suffering from rheumatoid arthritis, a disfiguring and disabling disease that can erode quality of life and shorten lifespan. *Orencia* is gaining share in the U.S., and we expect to launch it in Europe later this year.
- *Sprycel* addresses a serious and often deadly form of chronic myelogenous leukemia in patients who are resistant to or intolerant of Gleevec, the current standard of care. *Sprycel* is currently being marketed in the U.S. and recently has been launched in Europe.
- Atripla is a one-tablet, once-daily combination of our *Sustiva* medicine and a treatment from Gilead Sciences. Atripla joins *Sustiva* and *Reyataz* in our growing portfolio of innovative therapies for HIV/AIDS.
- EMSAM, licensed from Somerset Pharmaceuticals, is a transdermal patch that was introduced in the U.S. for treatment of serious depression in adults.

Sprycel and *Orencia* came from our own laboratories, and we continue to invest in extensive clinical programs exploring a range of potential uses for these promising medicines to help even more patients in the future. We are pursuing this “pipeline within a product” approach with other key products as well.

In addition to these launches, we expanded the reach of our other newer pharmaceuticals:

- Erbitux, a cancer treatment that we are codeveloping and copromoting with ImClone Systems Incorporated, continues to grow as a treatment for both advanced refractory colorectal cancer and, more recently, head and neck cancer.
- Abilify, an antipsychotic therapy that we are codeveloping and copromoting with Otsuka Pharmaceutical Co., Ltd., is benefiting from additional formulations that were approved in 2006.
- *Baraclude*, a treatment for chronic hepatitis B, continues to gain share, including in Asia where the disease is widespread. We currently are launching *Baraclude* in Japan as well as in Europe.
- The FDA approved a 300 mg single capsule formulation of *Reyataz* in combination therapy for adults with HIV-1.

In 2006, all of our key pharmaceuticals—with the exception of Plavix—grew at solid double-digit rates. Several additional products approached or surpassed the \$1 billion mark in total revenue or sales including: Abilify, *Reyataz* and—in our Mead Johnson Nutritional business—the *Enfamil* infant formula line.

Mead Johnson and our other related health care companies—ConvaTec and Bristol-Myers Squibb Medical Imaging—continue to provide strength and stability for the company, particularly in this transitional time for our pharmaceutical portfolio. Many of our key health care brands have solid additional growth potential, including Mead Johnson in Asia and Latin America, where market expansion is robust.

JAMES D. ROBINSON III

Chairman of the Board
(left)

and

JAMES M. CORNELIUS

Chief Executive Officer

PIPELINE ACHIEVEMENTS

Our pipeline continued to move forward in 2006. In addition to the new drug launches already mentioned, we transitioned one compound—apixaban, potentially for deep vein thrombosis—to late-stage (Phase III) development. We now have six compounds in Phase III, all addressing areas of significant unmet medical need. Three of those six—ixabepilone, vinflunine and ipilimumab—are in oncology, an area of historical strength for Bristol-Myers Squibb.

Our pipeline productivity is tied to several factors. First, we have consistently increased our investments in research and development, even during the past five years, when exclusivity losses drained substantial sums from our revenue base. Second, we restructured and refocused our R&D organization to improve processes, enhance quality of drug candidates and increase efficiency in clinical development.

Finally, in this era of cost and pricing pressures on our industry, we believe it is critically important to strategically manage our pipeline to ensure efficient use of resources and effectively manage risk and uncertainty. To that end, Bristol-Myers Squibb has successfully pursued a number of strategic partnerships with biotech and other pharmaceutical companies to strengthen our product portfolio, enhance our technology and sustain the productivity of our pipeline.

Earlier this year, we announced a worldwide collaboration with AstraZeneca to codevelop and co-commercialize saxagliptin and dapagliflozin, two of our diabetes compounds in development. We concluded a similar agreement with Otsuka Pharmaceutical Co., Ltd., for saxagliptin in Japan. Consistent with our strategy, these collaborations will enable us to share costs and risks for these innovative potential products in an area of significant unmet medical need.



GROWING IMPORTANCE OF BIOLOGICS

In the fight against serious disease, biologics—protein-derived therapies—are playing an increasingly prominent role. Erbitux and *Orencia* are biologics, as are ipilimumab, for cancer, and belatacept, for solid organ transplant rejection, in our pipeline. Producing biologics is complex and costly, and we are making significant investments to build our capabilities in this area.

We began several years ago with the conversion of our long-standing manufacturing site in Syracuse, New York, to a biologics center of excellence. In 2006, we announced nearly \$1 billion in new commitments to biologics manufacturing, including the expansion of an existing plant in Puerto Rico and the construction of a new state-of-the-art facility in Devens, Massachusetts. We are looking forward to breaking ground at the Devens location this year.

ORGANIZATIONAL CHANGES

The company made several leadership changes in 2006. In September, we announced the departure of Peter R. Dolan as chief executive officer and the appointment of James M. Cornelius, a member of the Board of Directors, as CEO on an interim basis. Peter had been the prime architect behind the company's strategic focus on serious diseases, and we are grateful for his many successes in executing the strategy and putting Bristol-Myers Squibb on a solid path forward. The search for a new CEO is continuing under the leadership of Jim Robinson, who is working closely with a Board committee in this effort.

The company also promoted Andrew R. J. Bonfield, chief financial officer, and Elliott Sigal, M.D., Ph.D., chief scientific officer and president, Pharmaceutical Research Institute, to executive vice president. They join Lamberto Andreotti, president, Worldwide Pharmaceuticals, who earlier had been named executive vice president. These three executives have played critical roles in developing and executing our strategy, and—together with many other outstanding leaders across the company—are committed to our success.

OUR PHARMACEUTICAL DEVELOPMENT PIPELINE

Bristol-Myers Squibb researchers are dedicated to discovering and developing innovative medicines that address serious unmet medical needs in key disease areas. Those areas, listed in the chart at right, were selected with an emphasis on where there remain significant patient needs as well as opportunities for leadership by the company.

Compounds and research programs in **Discovery** are at the earliest stages of research. Compounds in **Exploratory Development** are in preclinical or early clinical development. **Full Development** compounds are investigational drugs that are in late-stage clinical development or have been submitted to regulatory agencies for approval. **Life Cycle Management** compounds are among approved medicines that are

driving current and future growth while also undergoing continued clinical development to determine whether additional indications and formulations will benefit patients.

Throughout the Special Report beginning on page 7, we call attention to the importance of our ongoing clinical trials and we highlight responses from some of our individual clinical trial patients. While results may be unpredictable for any one participant in an individual experimental study, these personal accounts illustrate the importance of participation in clinical trials, which are essential to the development of the next generation of medical innovation. The true test is whether we can document a real clinical benefit across a significant number of research participants.

Our ability to bring new products to patients in need and to find new uses for our current products is dependent upon our demonstrating safety and efficacy and a favorable benefit-risk relationship via systematic testing in patients who volunteer to participate in our studies.

Like any other scientific endeavor, clinical testing of novel compounds is a complex, time-consuming, resource-intensive process with no guaranteed results. Bristol-Myers Squibb is committed to pursuing such clinical development and, in doing so, helping patients to prevail.

CORPORATE GOVERNANCE AND COMPLIANCE

There have been several key developments in the corporate governance and compliance areas. In 2006, the Board amended the bylaws of the company to adopt a majority voting standard for directors, and more recently it adopted a corporate governance guideline requiring a supermajority of independent directors to approve the compensation of the CEO. We believe these measures will further enhance accountability and transparency, and benefit our stockholders as well as our other stakeholders.

Compliance remains a top priority for all of us at Bristol-Myers Squibb. The compliance processes and mechanisms that the company put in place over the past several years are operating well, and we are always looking for

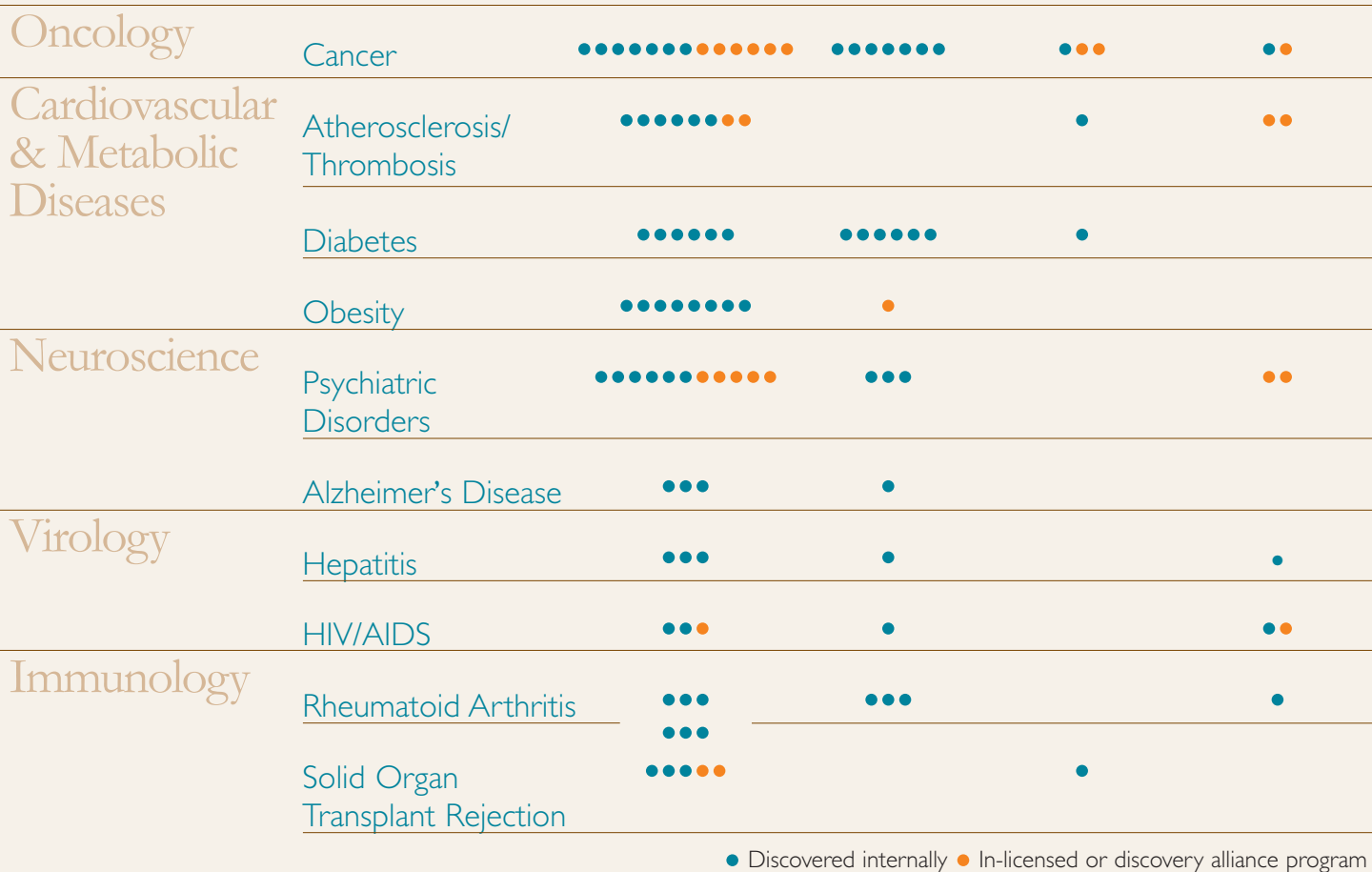
additional ways to strengthen this commitment. Intensive employee training on compliance matters continues, and we were honored to receive a "best practices" award in November 2006 from an organization of compliance professionals, recognizing our U.S. Healthcare Law Compliance Field Handbook.

Late last year, we announced an agreement in principle with the U.S. Department of Justice and the U.S. Attorney in Massachusetts to settle several investigations involving the company's drug pricing, and sales and marketing activities. These investigations began several years ago. As part of the civil resolution, the company agreed to pay \$499 million and enter into a corporate integrity agreement with the U.S. Department of Health and Human Services. We hope to conclude that agreement later

this year. We also are cooperating fully with the ongoing investigation by the Antitrust Division of the U.S. Department of Justice relating to the proposed settlement of the Plavix litigation.

As you will recall, the company is operating under a Deferred Prosecution Agreement with the U.S. Attorney in New Jersey. We continue to work closely with the Monitor appointed by the U.S. Attorney to ensure full compliance with the letter and spirit of the agreement.

DISEASE AREAS OF FOCUS



GOALS FOR 2007 AND BEYOND

Following a productive 2006, we are now focused on executing our strategy to maximize shareholder value. Assuming that we are successful in defending the Plavix patent—as well as growing our key products and advancing our pipeline—we expect sales and earnings to increase this year. And with few exclusivity losses expected in the near term, we are looking to sustain and build on this growth over the next several years.

Still, the overall environment is challenging for all companies across the pharmaceutical industry. Pricing pressures in particular are growing, including in the U.S., where the new prescription drug benefit under Medicare is having an impact.

To maintain our forward momentum, we must constantly examine our cost base to ensure that—to the maximum extent possible—it is supporting investment in growth opportunities. Over the past year, we made

solid progress with our productivity initiative, and are on track to achieve more than \$500 million in cost reductions in 2007 alone.

These savings are not solely the result of onetime spending cuts but rather reflect a systematic approach aimed at streamlining processes, simplifying governance and permanently removing low-value work. In this respect, they are part of a larger—and critical—effort to transform our company into a more efficient, flexible and dynamic organization for the future.

This year we plan to look for additional opportunities to drive efficiencies and reduce costs, again largely by scrutinizing the way we operate as a business. We cannot pretend this process will be painless. Across our entire industry, companies are facing difficult choices as they restructure. For us, it is important to lead this process in a way that builds strength, confidence and commitment to a better future for Bristol-Myers Squibb.

More than ever, science is our company's foundation, and in many respects our success is determined by our focus on scientific excellence. We see this commitment every day in the outstanding work of our R&D organization—and in the efforts of our thousands of other employees who transform innovative research into the products and services that extend and enhance human life.

Excellence in science is also a priority of the Board, and we were pleased last year to welcome two new members who have strong backgrounds in science and medicine. Vicki L. Sato, Ph.D., is professor of management practice at Harvard Business School and professor of the practice in the Department of Molecular and Cell Biology at Harvard University. R. Sanders Williams, M.D., is senior vice chancellor for academic affairs at Duke University Medical Center and dean of Duke University School of Medicine.

Drs. Sato and Williams serve on the Board's Science and Technology Committee, which was established last year. The Committee is chaired by Laurie H. Glimcher, M.D., Irene Heinz Given Professor of Immunology, Harvard School of Public Health, and professor of medicine, Harvard Medical School, who has been a member of the Board since 1997.

We believe it is imperative for the Board to be fully involved in developing and overseeing the company's R&D strategy, and in assessing the opportunities—and risks—in that strategy.

We also want to welcome to the Board Michael Grobstein, who is a distinguished retired vice chairman of Ernst & Young. He will serve on the Board's Audit Committee.

TOGETHER WE CAN PREVAIL

Ultimately, through our efforts in science, business and many other areas, we aim to help patients prevail in their fight against serious disease. That is the heart of our mission and the guiding spirit behind our strategy. It inspires us to succeed as a company and build value for our stockholders. Our 43,000 employees have demonstrated extraordinary commitment and resiliency during these challenging times, as they stayed focused on our mission and values.

We help people prevail with innovative products that make a difference in their lives. We also help by providing free medicines to patients in need, and by seeking to reduce health disparities around the world through the work of the Bristol-Myers Squibb Foundation. Last year, the company provided free medications worth more than \$400 million to approximately 570,000 people in the U.S., and—together with the Foundation—contributed \$87 million to health, education and community projects around the world.

In Africa, our \$150 million *SECURE THE FUTURE* initiative continues to make headway in the fight against HIV/AIDS by providing community-based treatment and care. We opened our third pediatric AIDS clinic in Africa—in Swaziland—and have broken ground on similar centers in Burkina Faso and Uganda. These centers, funded by Bristol-Myers Squibb, are operating in partnership with Baylor College of Medicine and national governments, and are bringing critically needed medical care to thousands of children and their families living with HIV.

In the Special Report that follows, you will learn about some remarkable people who have prevailed over significant health challenges with great courage and determination. We are proud that our company could play a part in their inspiring stories. As we look ahead, we are excited by the prospect of helping to create many more stories of hope and triumph. That vision will continue to drive us to make Bristol-Myers Squibb the best it possibly can be.



JAMES D. ROBINSON III
Chairman of the Board



JAMES M. CORNELIUS
Chief Executive Officer

March 7, 2007

At Bristol-Myers Squibb, our medicines have helped countless patients prevail over serious diseases such as cancer, HIV/AIDS and mental illness. We have stood beside patients to help them battle rheumatoid arthritis and hepatitis, heart disease and diabetes. Our health care products have enhanced the lives of millions. And our philanthropic programs have given new hope to some of the most vulnerable people in the world.

What sets us apart? At Bristol-Myers Squibb, we believe it's our commitment to patients with serious diseases, our focus on finding innovative medicines that combat those diseases, and our dedication to extending and enhancing human life.

This Special Report describes some of what we have done to change the course of disease for people everywhere. The stories in this section capture the determination of just a few of the individuals we have helped.

Their will. Our medicines.

Together we can prevail.

Prevailing over Cancer

The year 2006 marked the 35th anniversary of the National Cancer Act. With this Act, the U.S. declared “war on cancer.” Although much progress has been made since then, the war is far from won. Worldwide, nearly 11 million people are diagnosed with cancer annually.

Yet, from the earliest days in that struggle right up to today, Bristol-Myers Squibb has remained on the front lines.

“In the 1970s, when oncology was just a cottage industry,” says Robert Kramer, Ph.D., vice president, Oncology and Immunology Drug Discovery, “Bristol-Myers Squibb became the first company to drive research and treatments to the point where we were having an impact on cancer treatment with medicines.”

An early company entry was *Cytosan* (cyclophosphamide), a medicine still in use today. The 1980s saw the approval of several additional anticancer therapies—including cisplatin, carboplatin and etoposide. “There was a time when nearly all patients diagnosed with cancer died soon after diagnosis,” says Giovanni Caforio, M.D., senior vice president, U.S. Oncology. “These and other new agents began to change that.”

In the 1990s, Bristol-Myers Squibb took on a significant challenge—the development of TAXOL® (paclitaxel). Previously, paclitaxel had been derived solely from the bark of the Pacific yew tree, and quantities were severely limited. Within months, the company devised a method to dramatically improve the production of paclitaxel from natural sources. Large-scale clinical trials supported by the company proved the efficacy of TAXOL in the treatment of multiple types of cancer, thereby changing the course of cancer care for many patients.

In 2001, the company advanced the fight with more targeted therapies as it entered into an agreement with ImClone Systems Incorporated to develop Erbitux (cetuximab). Approved in the U.S. in February 2004 for certain patients with metastatic colorectal cancer, in March 2006 Erbitux became the first drug approved in 45 years for the treatment of

head and neck cancer. “The development of Erbitux clearly illustrates our company’s commitment to patients with cancer,” says Caforio.

Bristol-Myers Squibb is building on that commitment. *Sprycel* (dasatinib), for the treatment of patients with chronic myelogenous leukemia and Philadelphia chromosome-positive acute lymphoblastic leukemia who are resistant or intolerant to prior therapy, was discovered by Bristol-Myers Squibb and developed in record time. *Sprycel* was approved in the U.S. in June 2006 and in Europe in November 2006. Clinical trials are under way to evaluate the effectiveness of *Sprycel* in other hematologic malignancies and solid tumors.

Among our oncology compounds in late-stage clinical development are ixabepilone, a compound in a new class of drugs discovered and developed in company labs for the treatment of breast cancer; vinflunine, licensed from Pierre Fabre Médicament for the treatment of bladder cancer; and ipilimumab, licensed from Medarex, Inc. for the treatment of metastatic melanoma.

“We’re executing a strategy intended to provide patients with a broad range of product types: traditional cell-killing chemotherapeutic agents, targeted biologics, signal transduction inhibitors that prevent tumor growth and immunomodulators that use the body’s own immune system to fight cancer,” says Martin Birkhofer, M.D., vice president, Oncology Global Medical Affairs.

Bristol-Myers Squibb’s commitment to patients remains the hallmark of its legacy of innovative cancer treatments. “People always ask if there will be a cure for cancer,” says Renzo Canetta, M.D., vice president, Oncology Global Clinical Research. “With early detection and more-powerful treatments, I see more and more patients doing well every day. Increasingly, we understand that cancer can be something patients live *with*, not die *from*.”



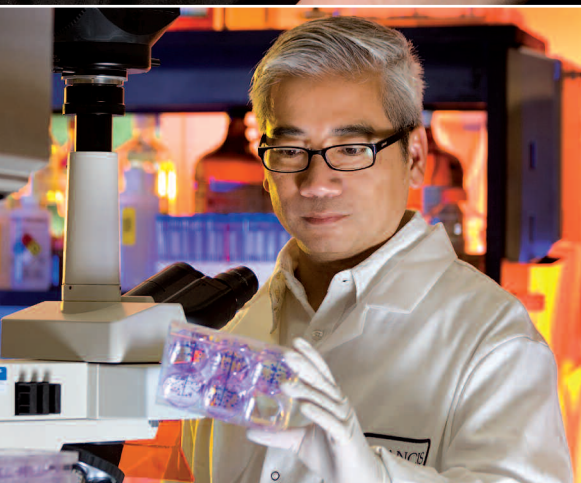
▲ When Jan Johnsen of London was diagnosed with chronic myelogenous leukemia, he recalls, “It was the most shocking day of my life.” When Johnsen’s treatments failed, his doctor suggested he enter a clinical trial with *Sprycel*. “It’s almost impossible to describe the joy you feel when you know that you have a treatment that helps fight a life-threatening illness,” Johnsen says.



SHARON COORDS-BELVIN

Two weeks before her wedding, Sharon Coords-Belvin, seen here with her husband, Rob, thought she had bronchitis. But it was the diagnosis that left her breathless: metastatic melanoma. "I literally fell over backwards," she says. Despite chemotherapy, the tumors quickly spread to her lungs, lymph nodes and brain. Then, she enrolled in a clinical trial for ipilimumab, an investigational biologic. Today, Sharon appears to be doing well.

"Now, when I talk with my husband about our dreams for the future, it brings tears to my eyes."



◀ Frank Lee, a research fellow in Discovery Biology at Bristol-Myers Squibb, has spent most of his life studying cancer to find better treatments. "I'm in cancer research simply because that is where I want to be," he says. "I know that there are people out there waiting for us to come up with better medicines, with hope for a cure. It's what makes me come to work every day."

OPHELIA HAANYAMA

When Ophelia Haanyama, a Swedish citizen born in Zambia and living in Stockholm, tested positive for HIV in 1990, she did not understand why something as small as a virus couldn't be cured. Haanyama was determined to fight back. She began treatment, completed her high school education and then went on to study microbiology, physiology and public health. Today, she is a senior adviser for the Noah's Ark-Red Cross Foundation Sweden, an HIV/AIDS education, information and support program. As part of her treatment, Haanyama takes *Reyataz*. Her hope for the future is a simple one—

“An AIDS-free world, a world more open and proud of being healthy.”



Prevailing over HIV and Hepatitis

HIV/AIDS

When AIDS was first identified about 25 years ago, there were few treatment options available to patients. Now, while there are still no cures, drug treatments—such as *Videx EC* (didanosine), *Zerit* (stavudine), *Sustiva* (efavirenz), *Reyataz* (atazanavir sulfate) and *Atripla* (efavirenz 600 mg/emtricitabine 200 mg/tenofovir disoproxil fumarate 300 mg), all of them marketed or comarketed by Bristol-Myers Squibb—have turned HIV into a treatable disease for many.

Today there are some 2.1 million people in North America and Western Europe living with HIV/AIDS.

“For HIV,” says Ann Kolokathis, M.D., vice president, Virology, Global Medical Affairs, “it is important not only to provide patients with effective treatments but also to simplify their therapies. That’s what makes a compound like *Atripla* so important.” *Atripla*, the result of a joint venture between Bristol-Myers Squibb and Gilead Sciences, was approved for marketing in the U.S. in July 2006. It is the first-ever once-daily, single-tablet regimen intended as a stand-alone therapy or as part of combination therapy with other medicines for the treatment of HIV in adults.

The company is pursuing opportunities in two new classes of drugs—attachment inhibitors and integrase inhibitors—that attack the AIDS virus in novel ways. Drug candidates have already been tested in early clinical trials. “If two or three new classes of HIV drugs can be introduced in addition to existing classes, doctors should be able to provide patients with sufficient options to fight HIV for a long time,” says Richard Colonno, Ph.D., vice president, Infectious Diseases Drug Discovery.

Unfortunately, outside of North America and Western Europe, many HIV-positive individuals, particularly those in southern Africa, do not have adequate access to medicines or health care. Through programs such as *SECURE THE FUTURE*, Bristol-Myers Squibb is helping address these needs. For more on these groundbreaking efforts, please see page 20.

HEPATITIS

Worldwide, about 400 million people are chronically infected with hepatitis B virus (HBV). About 75 percent of them are in Asia—130 million in China alone.

Baraclude (entecavir) was discovered by Bristol-Myers Squibb scientists and found to block all three stages of HBV DNA replication. The medication was approved in the U.S. in March 2005 and has since become available to patients in more than 50 countries and regions, including China. “*Baraclude* reduces the viral load of hepatitis B in those infected and, in certain patient populations, studies have shown *Baraclude* to reduce viral load to undetectable levels in many patients,” Kolokathis says.

Hepatitis C is another serious viral infection that can result in cirrhosis and liver cancer. Between 150 million and 200 million people are infected worldwide. Hepatitis C is the leading cause of liver transplants in the U.S. The company is hard at work pursuing multiple targets and potential drug combinations to achieve an oral regimen—what Colonno calls “the Holy Grail for hepatitis C treatment.”

▼ Peng Zhaoran likes to learn, spending his free time in libraries and bookstores in Beijing. But then he learned something that could change his life forever. A routine blood test revealed he was infected with the hepatitis B virus. “I did not suffer any pain,” Zhaoran says, “but I was very worried.” His doctor recommended treatment with *Baraclude*. “Now I treasure each day with my family. I feel I am a lucky person.”



▲ Brian Coppedge, left, Patient and Community Affairs manager at Bristol-Myers Squibb, with Francisco Valdés, a treatment adherence counselor for AltaMed Health Services in East Los Angeles. “I’m HIV-positive myself,” says Coppedge, “so I understand the hurdles that HIV patients must overcome. While a patient may need to take only one pill a day, it is still a lifelong regimen that must be carefully maintained. Staying healthy is an ongoing effort.”

Prevailing over Autoimmune

Rheumatoid arthritis is an autoimmune disease in which the body's own defense cells mistakenly attack the joints in the body, leaving its victims in pain, disabled and sometimes crippled for life. About 1 percent of the world's population is afflicted with rheumatoid arthritis, including more than 2 million Americans. About 75 percent of those affected are women.

Rheumatoid arthritis often requires long-term therapy. But because many treatments provide inadequate relief, many patients still live with pain, discomfort and a decreased quality of life.

Orencia (abatacept) was discovered and developed by scientists at Bristol-Myers Squibb. First approved in the U.S. in December 2005, *Orencia* is a novel biologic for adult patients with moderate to severe rheumatoid arthritis who have not been helped by other medications. "*Orencia* offers a novel way of treating rheumatoid arthritis patients," says Mark Kreston, vice president, Immunoscience Global Brand Commercialization.

Orencia also represents a pipeline of potential new indications for other autoimmune disorders. It is now in investigational trials for lupus, Crohn's disease and ulcerative colitis.

Belatacept is an investigational biologic engineered by Bristol-Myers Squibb scientists to target the immune system for a different purpose: to prevent solid organ transplant rejection. It is currently in Phase III clinical trials in kidney transplant patients. "We hope that belatacept will ultimately help transform the practice of transplant medicine," says Elliott Levy, M.D., vice president, Immunology Global Clinical Research.

Currently, more than 300,000 patients in the U.S. and Europe live with transplanted organs, and about 50,000 receive new transplants every year. To prevent rejection, transplant recipients require lifelong therapy with potent immunosuppressive drugs. "Current drugs are very effective at preventing acute rejection, but do so at a heavy cost in terms of side effects," Levy says. In the long term, immunosuppressive drugs can contribute to high blood



▲ Over the years, Barbara Whitehead was finding it more and more difficult to do the simple things in life, like getting out of a chair or playing with her grandchildren. "I got to the point where I hurt all the time." Whitehead was diagnosed with rheumatoid arthritis. After several unsuccessful courses of treatment, she entered a clinical trial for *Orencia*. After three treatments with *Orencia*, she says, "I could feel a difference. It felt like hope."

pressure, high cholesterol levels, diabetes and kidney toxicity. Transplant patients risk cardiovascular disease and premature graft loss. Says Levy, "If we can meet the standard of efficacy and improve on the safety profile of current transplant drugs with belatacept, that will be a huge advance."

Kreston adds, "With five different disease programs in the clinic—rheumatoid arthritis, Crohn's disease, ulcerative colitis, lupus and solid organ transplant rejection—plus our manufacturing commitment to a new biologics facility being built in Devens, Massachusetts, you can see a clear commitment to biologics. And that translates into a great many possibilities for making a real difference for patients."



▲ Biologics Process Operator Jill Reinhard and colleague monitor the 5,000-liter fermentation bioreactors where cells are grown to produce *Orencia*. Each bioreactor contains 25 trillion cells, which equals one treatment for 1,200 rheumatoid arthritis patients. It takes about 50 days of exacting processes to manufacture the bulk product here at the company's Syracuse, New York, facility.

Disorders

JAMES HARRIS

In July 2006, after being on dialysis for six years, James Harris got a new lease on life—a kidney transplant. “Dialysis took a lot out of me,” he says. After the transplant, Harris entered a clinical trial for belatacept, an investigational treatment designed to prevent organ transplant rejection. Since the transplant, Harris has been spending more time with his family and more time fishing.

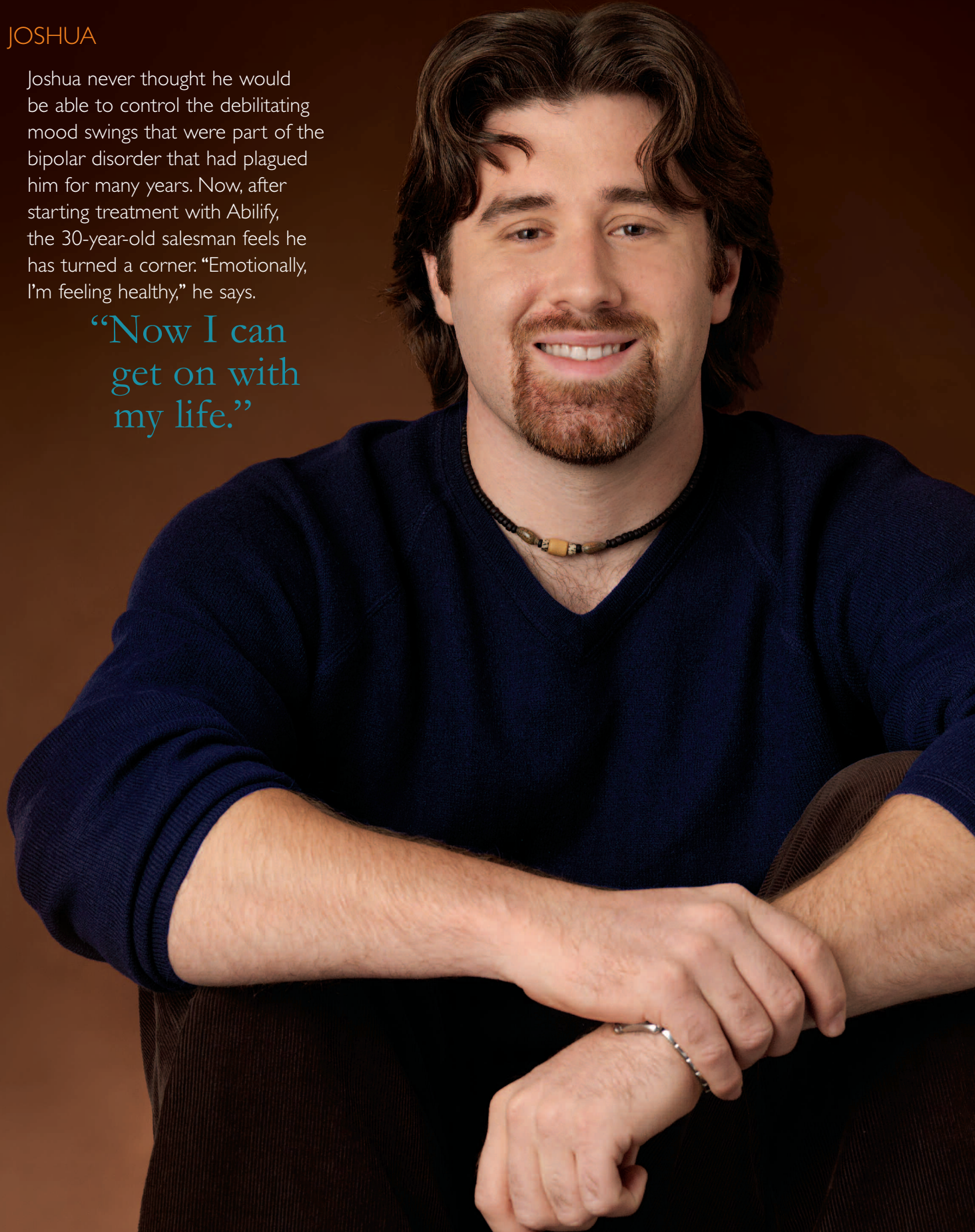
“Now I’m
enjoying life
more.”



JOSHUA

Joshua never thought he would be able to control the debilitating mood swings that were part of the bipolar disorder that had plagued him for many years. Now, after starting treatment with Abilify, the 30-year-old salesman feels he has turned a corner. "Emotionally, I'm feeling healthy," he says.

**"Now I can
get on with
my life."**





◀ Yu-Wen Li, Ph.D., principal scientist in Neuroscience Biology, confers with his colleague, Research Scientist Kelly Lengyel. “Autoradiographic images of human brain sections tell us where our drug target is located,” he explains. “This technology allows us to more rapidly and more effectively design the next generation of drugs to treat serious psychiatric and neurological disorders, such as major depressive disorder and Alzheimer’s disease.”

◀ Susan Fredriksen is a psychiatrist who knows only too well the pain of depression. For years she had been haunted by recurrent depressive episodes. Then, in 2004, she fell into a serious depression. In July 2006, Fredriksen was prescribed EMSAM. “My best friend told me that I sound like I am doing better. I told her, ‘That’s because I am.’”

Prevailing over Mental Illness

Many patients with schizophrenia and other serious mental illnesses cycle from medicine to medicine and may even discontinue treatment.

“Patients are often unable to tolerate the side effects or do not achieve adequate symptom control,” says Kevin Trapp, vice president, Neuroscience Marketing. “Certain side effects, such as weight gain and sedation, may influence a person’s willingness and ability to stay on medication.”

Studies suggest that Abilify (aripiprazole) may work differently from most other antipsychotic medications, raising levels of certain neurotransmitters when they are low and reducing levels when they are too high. Because of its unique profile and benefits for patients, Abilify has enjoyed extraordinary sales growth since its introduction in 2002.

While revenues are certainly important, for the Abilify team, helping patients is the prime concern. In just four years, Abilify has been granted five indications: acute and maintenance treatment of schizophrenia, acute and maintenance treatment of bipolar mania and, most

recently, Abilify Injection, for agitation associated with schizophrenia or bipolar mania. Together with Otsuka Pharmaceutical Co., Ltd., Bristol-Myers Squibb continues to develop clinical programs for potential expanded uses of Abilify.

More than 1.7 million patients have been prescribed Abilify to date. “Schizophrenia and bipolar disorder are debilitating diseases,” says Adam Lenkowsky, director, Neuroscience Strategy. “Yet when you meet some of the patients who have been treated with Abilify, and you hear them talk about their lives and how they have changed, it’s truly touching.”

But the focus on mental illness for Bristol-Myers Squibb only begins with Abilify. EMSAM (selegiline transdermal system), a transdermal patch for major depressive disorder, was approved in February 2006, resulting from a partnership with Somerset Pharmaceuticals. As a transdermal patch, EMSAM is directly and continuously absorbed into the bloodstream.

Abilify and EMSAM are backed by a growing pipeline of other compounds in development. A CRF receptor antagonist for depression is in early clinical development, and other compounds that focus on novel approaches to treat anxiety and schizophrenia, as well as compounds to help slow the progression of Alzheimer’s disease, closely follow. The company also has extended a research alliance with Lexicon Genetics to look at 5,000 different genes expressed in the brain as potential novel targets for future psychiatric drugs.

“We’ve made great strides in the treatment of both psychiatric and neurological illnesses, yet these remain areas of significant unmet medical need for many patients,” says Jack Grebb, M.D., vice president, Neuroscience Global Clinical Research. “Our hope is that with continuing advances in genetics, we will identify new molecular targets in the brain and be able to direct our innovative drugs against them.”

Prevailing over Heart Disease and Diabetes

More than 52 million patients have been prescribed Plavix (clopidogrel bisulfate) since it was first made available to patients in 1997. Plavix provides a balanced safety and efficacy profile in a broad range of indicated patients. It is used to reduce the risk of heart attack in patients who have had a recent heart attack or recent ischemic stroke or who are diagnosed with peripheral artery disease. In 2006, Plavix, taken with aspirin, was approved to reduce the risk of death from any cause and the risk of heart attack, stroke or death in patients who have experienced the most severe form of heart attack. This additional indication expanded the use of Plavix, taken with aspirin, to reduce the risk of heart attack and stroke across the entire spectrum of acute coronary syndrome.

Plavix has been exhaustively studied in one of the largest clinical trial programs ever developed, involving more than 100,000 patients over many years. Yet, for Bristol-Myers Squibb and its partner sanofi-aventis, the work to find additional benefits and treatment options for patients is far from over.

Trials are under way in patients with peripheral bypass grafts, patients with atrial fibrillation, and those undergoing angioplasty. Another trial is ongoing in children with congenital heart disease. More than 20,000 patients will be enrolled worldwide in these new investigational studies.

“We have always believed that Plavix has the potential to dramatically improve the standard of care for the millions of patients who are at risk of future atherothrombotic events,” says Brian Gavin, Ph.D., executive director, Global Medical Affairs. “That’s why we have spent hundreds of millions of dollars exploring new benefits for patients while also continuing to improve the current usages.”

Behind Plavix, a new generation of oral antithrombotic agents is emerging from the research pipeline, including apixaban, now in Phase III clinical trials.

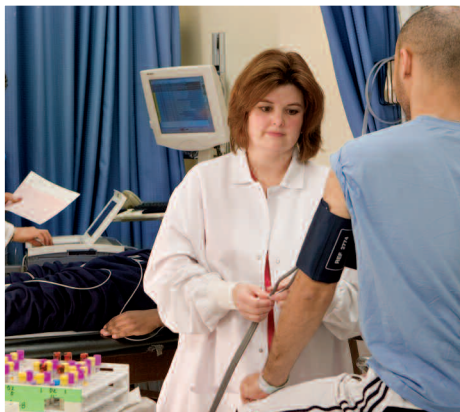
Bristol-Myers Squibb’s focus on the patient extends to many other areas, including hypertension. “Most people with hypertension are not adequately controlling high blood pressure,” says Pablo Lapuerta, M.D., executive director, Global Medical Affairs. Together with sanofi-aventis, Bristol-Myers Squibb is studying Avapro/Avalide (irbesartan), an advanced antihypertensive, for additional uses, including first-line treatment of severe hypertension, heart failure and atrial fibrillation.

Diabetes is another area of intensive research. “Even among those patients being treated for diabetes, only about half are successfully controlled,” says Chris Cann, vice president, Global Brand Commercialization. The company currently has two novel compounds in later stages of development: saxagliptin and dapagliflozin. In January 2007, Bristol-Myers Squibb and AstraZeneca agreed to develop and market these two drugs in partnership. In Japan, saxagliptin will be developed and commercialized in partnership with Otsuka Pharmaceutical Co., Ltd.

Obesity is also a growing health issue worldwide and a major contributor to cardiovascular disease and diabetes. Currently in Phase II clinical trials is a CBI antagonist targeting receptors that help control appetite.

“Our job at Bristol-Myers Squibb is to live our company’s mission to extend and enhance human life,” says Sharon Henry, M.D., vice president, Cardiovascular and Metabolics Global Medical Affairs. “As scientists and clinicians, we must stay focused on the patient.”

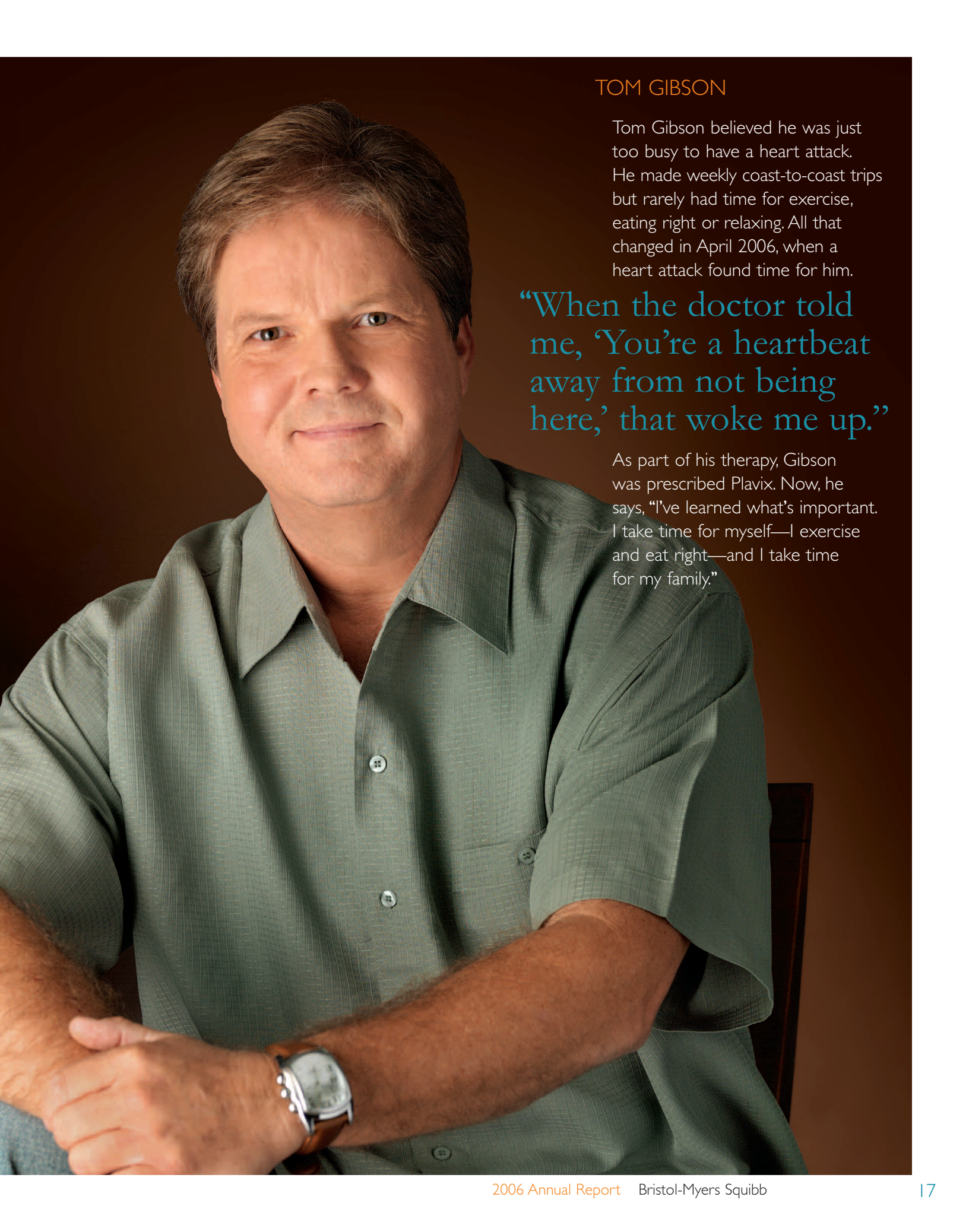
▶ Kim Smith, a registered nurse at the Bristol-Myers Squibb Clinical Pharmacology Unit in Hamilton, New Jersey, takes vital signs of a



healthy volunteer testing one of the company’s new investigational compounds for diabetes. Health care professionals at this state-of-the-art, 60-bed facility perform the first clinical assessments on compounds approved for Phase I clinical trials. Says Smith, “Our first priority is the safety of the volunteers.”



▲ In June 2005, Richard Harper stepped on some broken glass. He didn’t feel pain and didn’t know he was injured, but days later his foot became swollen. Harper was diagnosed with diabetic neuropathy, which causes peripheral numbness. “I didn’t even know I had diabetes,” he says. Harper entered a clinical trial for saxagliptin, an investigational new drug for type 2 diabetes. He also made lifestyle changes, improving his diet and exercising. Now, he says, “I feel better.”



TOM GIBSON

Tom Gibson believed he was just too busy to have a heart attack. He made weekly coast-to-coast trips but rarely had time for exercise, eating right or relaxing. All that changed in April 2006, when a heart attack found time for him.

“When the doctor told me, ‘You’re a heartbeat away from not being here,’ that woke me up.”

As part of his therapy, Gibson was prescribed Plavix. Now, he says, “I’ve learned what’s important. I take time for myself—I exercise and eat right—and I take time for my family.”

Enhancing Lives

and Prevailing over Health Challenges

Bristol-Myers Squibb's Health Care Group, which consists of Mead Johnson Nutritionals, ConvaTec and Bristol-Myers Squibb Medical Imaging, plays an important part in the company—with over \$4 billion in sales in 2006.

"The role of the Health Care Group is in line with Bristol-Myers Squibb's strategy by delivering strength and stability in a way that enhances shareholder value," says Health Care Group President John Celentano. "We succeeded in that role during 2006, and we are already building on it for 2007. We're doing what is most important: focusing on our broad and enduring commitment to help our customers." The Health Care Group's three businesses help fulfill the company's mission to enhance human life through their related health care products and services.

MEAD JOHNSON NUTRITIONALS

No matter where they live or what language they speak, parents worldwide are united by one desire: They want their children to have the best start in life. Mead Johnson and its approximately 5,000 employees worldwide are dedicated to help in that same proposition. And that, says Luanne Flikkema, vice president, Mead Johnson Global Marketing Resources, is the driving force behind developing Mead Johnson products. "By meeting the needs of parents around the world, we're not just making an effort; we're making a difference."

For example, Mead Johnson is a world leader in providing innovative, science-based nutritional products for infants and children. The company has pioneered products that help those with inborn metabolic disorders grow and develop to their full potential. Mead Johnson's commitment to healthy infants as well as to the small number of families dealing with inborn metabolic disorders reflects the care and exacting attention the company gives to all of its more than 60 brand-name products available in more than 70 countries.

Throughout 2006, Mead Johnson's *Enfamil* infant formulas as well as toddlers' and children's nutritional products continued to earn the trust of parents and health care professionals worldwide. The company's Intercontinental business was distinguished by strong sales and growth in all regions, most notably in Asia and Latin America. *Enfa* franchise products, including *Enfapro*, *Enfagrow* and *Enfakid*, fueled this growth.

"We are committed to continued growth in our intensely competitive industry. During 2007, we will remain focused on executing our strategies flawlessly and investing in our key growth drivers," says Mead Johnson President Stephen W. Golsby.

CONVATEC

ConvaTec, Bristol-Myers Squibb's wound therapeutics and ostomy care business, achieved a landmark \$1 billion in sales for the first time in 2006. ConvaTec President David Johnson attributes this milestone performance to the customer-driven focus of the company's employees. "This milestone is a reflection of our heritage, passion and vision," he says. "Our customers know us for our history of bringing needed products to market, for the compassion and integrity with which we serve our patients, and for the innovative technologies and quality products and product-related services we provide."

Among ConvaTec's industry-leading products are *SUR-FIT Natura* and *Esteem* ostomy systems, the *Flexi-Seal FMS* fecal management system, and key brands in wound therapeutics including *AQUACEL* wound dressings and *AQUACEL Ag* antimicrobial wound dressings, incorporating innovative *Hydrofiber* technology.

► Brothers Alex Lazarus, age 13, Brennen Cubic, age 7, and William Cubic, age 2, don't share the same DNA. But they do share the same rare, inherited metabolic disorder—phenylketonuria, or PKU. The boys, who began life thousands of miles apart, became a family when Brennen and Will were adopted from Russia by Alex's parents, Barbara and John Cubic. The boys' bodies can't metabolize phenylalanine, an essential amino acid found in proteins. "But," says their mom, "that will never break their spirit." Brothers now in more ways than one, they stick together as they manage their strict, low-protein diet that includes Mead Johnson's *Phenyl-Free 2* and *Phenyl-Free 2 HP* phenylalanine-free dietary powders.

MEDICAL IMAGING

"Helping customers and patients prevail over challenges is literally 'at the heart' of our medical imaging business," says Bristol-Myers Squibb Medical Imaging President Tim Ravenscroft. The business helps physicians enhance cardiovascular patient care with pioneering cardiovascular imaging agents such as *Cardiolite* (Kit for the Preparation of Technetium Tc99m Sestamibi for Injection) and *DEFINITY* Vial for (Perflutren Lipid Microsphere) Injectable Suspension.

"This commitment will continue to guide us as we work hard to extend the benefits of *DEFINITY* to patients in Europe and throughout other parts of the world during 2007," he adds.



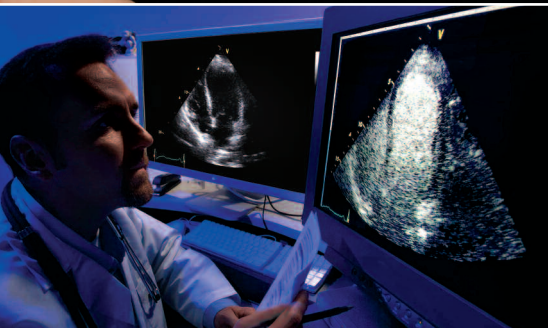


ABBY RYAN

Diagnosed with ulcerative colitis when only 14 months old, Abby Ryan has had a lot to overcome. At age 3 her large intestine was removed. At age 11 she received a full ileostomy. And at age 20 she was diagnosed with Crohn's disease. Ryan is fitted with a drainable ConvaTec pouching system. "I once had the fear that I wouldn't have a life," she says.

"Now, I realize there are no limitations to what I can do when I set my mind to it."

Ryan, a senior at the University of Wisconsin-La Crosse, is on the dean's list. She is involved with the Miss America Pageant and has won the titles of Miss LaCrosse/Oktoberfest, Miss Western Wisconsin, Miss Midwest and Miss Mississippi Valley. What's more, Ryan travels as a motivational speaker, delivering her personal message of hope for those who suffer from Crohn's disease and colitis.



◀ **DEFINITY Vial for (Perflutren Lipid Microsphere) Injectable Suspension**, the leading echocardiography contrast agent in the U.S., enables physicians to improve patient care by converting suboptimal images to evaluable ones. **DEFINITY** consists of gas-filled microspheres that, when exposed to ultrasound waves, "echo" back strong signals, creating an increased level of contrast. The image on the right represents a **DEFINITY**-enhanced echocardiogram. The suboptimal image on the left was obtained from a study using echocardiography alone.

Prevailing over Health Disparities

For millions around the world, when they get sick, treatments are limited or not available. All too often, patients are disadvantaged financially, socially or geographically. And certain groups—including women, children and minorities—are more likely than others to experience barriers to health care.

Bristol-Myers Squibb recognizes these health disparities and seeks to address them. In early 2007, the Bristol-Myers Squibb Foundation announced that it was embarking on a new initiative: to help strengthen community-based health care worker capacity and integrate medical care and community-based supportive services. The aim: to mobilize communities to fight disease and improve health outcomes.

The Foundation is targeting four specific diseases and regions: hepatitis in Asia, serious mental illness in the U.S., cancer in Europe and HIV/AIDS in Africa.

Although this initiative is just now beginning, the cornerstone has already been laid by the work done in Africa through the Bristol-Myers Squibb *SECURE THE FUTURE* program, addressing women and children affected by HIV/AIDS. "Our focus on children in projects like the Pediatric AIDS Corps and the Children's Clinical Centers of Excellence has helped us better understand how to build bridges to better health," says Foundation President John Damonti. "And our work with community-based treatment support sites has given us a new appreciation of the role that communities can play in improving health outcomes."



▲ Bristol-Myers Squibb and Baylor College of Medicine established the first medical center in Lesotho dedicated to caring for HIV/AIDS-infected infants, children and their families. Other pediatric centers of excellence have been established in Botswana and Swaziland. Centers in Burkina Faso and Uganda are scheduled to open in 2007.

During 2006, the first contingent of 50 North American pediatricians and family practitioners arrived at their posts in Africa as part of the Pediatric AIDS Corps. These doctors are treating HIV-positive children and their families at the Children's Clinical Centers of Excellence developed by Bristol-Myers Squibb and Baylor College of Medicine. Over the next five years, physicians of the Pediatric AIDS Corps are expected to treat up to 80,000 HIV-infected children and train hundreds of health care workers.

The AIDS pandemic has demanded innovative partnerships. In February 2006, Bristol-Myers Squibb announced a landmark agreement with two generic manufacturers (in India and South Africa) for full technology transfer and voluntary licenses covering sub-Saharan Africa for *Reyataz*, the company's advanced protease inhibitor. Bristol-Myers Squibb has also granted immunity from suit for *Videx* and *Zerit* to generic manufacturers for the benefit of patients in the region.

▶ JoAnna Leyenaar, M.D., a pediatrician from Ottawa, Canada, treating an HIV-positive infant at the Children's Clinical Center of Excellence in Lesotho. "I joined the Pediatric AIDS Corps to help people who really need care," she says. "Pediatric HIV care has lagged behind in too many countries. It's great to see children in Lesotho receiving care, recovering and thriving."

Additionally, Bristol-Myers Squibb makes its HIV medicines available in sub-Saharan Africa and a number of other low-income countries at prices reflecting no profit to the company. The company also provides its pediatric HIV formulations at a significant discount in these countries.

In 2006, the company became a founding partner in a new pediatric initiative of the President's Emergency Plan for AIDS Relief. "For the first time," says Donne Newbury, who coordinates the company's global HIV access programs, "a public-private partnership has been created to address the need for pediatric formulations that will help open up access to HIV treatments for millions."

In addition to these efforts, Bristol-Myers Squibb has consolidated its patient assistance programs in the U.S. into a single *LifeLines of Care* initiative that continues to provide assistance for qualifying patients with financial hardships. During 2006, approximately 570,000 patients in the U.S. benefited, with donated products valued at more than \$418 million at wholesale list price.



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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

EXECUTIVE SUMMARY

About the Company

Bristol-Myers Squibb Company (BMS, the Company or Bristol-Myers Squibb) is a worldwide pharmaceutical and related health care products company whose mission is to extend and enhance human life by providing the highest quality pharmaceutical and related health care products. The Company is engaged in the discovery, development, licensing, manufacturing, marketing, distribution and sale of pharmaceuticals and related health care products.

The Company has three reportable segments—Pharmaceuticals, Nutritionals and Other Health Care. The Pharmaceuticals segment is comprised of the global pharmaceutical and international consumer medicines business and accounted for approximately 77% of the Company's 2006 net sales. The Nutritionals segment consists of Mead Johnson Nutritionals (Mead Johnson), primarily an infant formula and children's nutritionals business, which accounted for approximately 13% of the Company's 2006 net sales. The Other Health Care segment consists of the ConvaTec and Medical Imaging businesses, which accounted for approximately 10% of the Company's 2006 net sales.

2006 Financial Highlights

The Company has made progress with its long-range strategy, despite some significant challenges that occurred during the year, including the at-risk launch of generic clopidogrel bisulfate product by another company, which adversely impacted Plavix sales, the loss of exclusivity of *Pravachol* in the United States (U.S.) and in certain European markets, and an increase in litigation reserves. The Company launched several important products in 2006, including *Orencia*, *Sprycel* and, with Gilead Sciences, Inc. (Gilead), *Atripla*. *Orencia* and *Sprycel* continue to gain market share and, along with double digit sales growth in 2006 for *Abilify*, *Reyataz*, *Erbitux*, the *Sustiva* Franchise and *Baraclude*, are key components of a strong product line for long-term growth.

The Company continues to invest in its late stage compounds and the development of new products. With the growing importance of biologics, in February 2007, the Company completed the land purchase for its major new biologics facility in Devens, MA, along with expansion of existing facilities in Syracuse, NY, and Manati, Puerto Rico. Construction on the Devens facility is scheduled to begin in early 2007.

Worldwide net sales from continuing operations for 2006 decreased 7% to \$17.9 billion compared to 2005. Worldwide net sales of the products that the Company views as growth drivers increased by 6% in 2006 as compared to the same period in 2005. Excluding Plavix, worldwide net sales of the other growth drivers increased 32% in 2006 as compared to the same period in 2005. Products that the Company considers to be growth drivers are Plavix, *Avapro/Avalide*, *Abilify*, *Reyataz* and *Erbitux*.

Net income was \$1.6 billion in 2006 compared with \$3.0 billion in 2005. The 2006 results include a \$353 million increase in reserves for a pricing and sales litigation settlement and \$220 million in early debt retirement costs. The 2005 results included \$370 million gain on the sale of the Consumer Medicines business.

Plavix

The Company's largest product ranked by net sales is Plavix (clopidogrel bisulfate) with U.S. sales of \$2.7 billion in 2006, \$3.2 billion in 2005 and \$2.8 billion in 2004. The composition of matter patent for Plavix, which expires in 2011, is currently the subject of patent litigation in the U.S. with Apotex Inc. and Apotex Corp. (Apotex) and with other generic companies, as well as in other less significant jurisdictions. The Company has previously disclosed certain developments in the pending Plavix litigation with Apotex, including the at-risk launch of a generic product by Apotex in August 2006.

As noted above, Apotex launched a generic clopidogrel bisulfate product that competes with Plavix on August 8, 2006. On August 31, 2006, the U.S. District Court for the Southern District of New York (the Court) granted a motion by the Company and its product partner, Sanofi-Aventis (Sanofi), to enjoin further sales of Apotex's generic clopidogrel bisulfate product, but did not order Apotex to recall product from its customers. The Court's grant of a preliminary injunction has been affirmed on appeal. The trial in the underlying patent litigation ended on February 15, 2007 and the Court is expected to rule following post-trial briefing.

The at-risk launch of generic clopidogrel bisulfate had a significant adverse effect on net sales of Plavix in 2006, which the Company estimates to be in a range of \$1.2 billion to \$1.4 billion. In particular, the launch had a significant adverse effect on sales in the third quarter, which the Company estimates to be in the range of \$525 million to \$600 million, as well as in the fourth quarter of 2006, which the Company estimates to be in the range of \$700 million to \$750 million. In the first, second, third and fourth quarters of 2006, U.S. net sales for Plavix were \$850 million, \$988 million, \$474 million and \$343 million, respectively. Estimated total U.S. prescription demand for clopidogrel bisulfate (branded and generic) increased by 14% in 2006 compared to 2005, while estimated

total U.S. prescription demand for branded Plavix decreased by 18% in the same period. The Company expects generic clopidogrel bisulfate that was sold into distribution channels following the Apotex at-risk launch in August 2006 will have a residual impact on Plavix net sales and the Company's overall financial results into 2007. The full impact of Apotex's launch of its generic clopidogrel bisulfate product on the Company cannot be reasonably estimated at this time and will depend on a number of factors, including, among others, the amount of generic product sold by Apotex; whether the Company and Sanofi (the Companies) prevail in the underlying patent litigation; even if the Companies prevail in the pending patent case, the extent to which the launch by Apotex will permanently adversely impact the pricing and prescription demand for Plavix, the amount of damages that would be sought and/or recovered by the Companies, and Apotex's ability to pay such damages. Loss of market exclusivity of Plavix and/or sustained generic competition would be material to the Company's sales of Plavix, results of operations and cash flows, and could be material to the Company's financial condition and liquidity.

The Company's U.S. territory partnership under its alliance with Sanofi is also a plaintiff in three additional pending patent infringement lawsuits against Dr. Reddy's Laboratories, Inc. and Dr. Reddy's Laboratories, LTD (Dr. Reddy's), Teva Pharmaceuticals USA, Inc. (Teva) and Cobalt Pharmaceuticals Inc. (Cobalt), all related to the U.S. Patent No. 4,847,265 (the '265 Patent). A trial date for the action against Dr. Reddy's has not been set. The patent infringement actions against Teva and Cobalt have been stayed pending resolution of the Apotex litigation, and the parties to those actions have agreed to be bound by the outcome of the litigation against Apotex, although Teva and Cobalt can appeal the outcome of the litigation. Each of Dr. Reddy's and Teva have filed an Abbreviated New Drug Application (aNDA) with the U.S. Food and Drug Administration (FDA), and all exclusivity periods and statutory stay periods under the Hatch-Waxman Act have expired, with the exception of the 30-month stay that applies to Teva, which expires on February 27, 2007. Accordingly, final approval by the FDA would provide each company authorization to distribute a generic clopidogrel bisulfate product in the U.S., subject to various legal remedies for which the Companies may apply including injunctive relief and damages.

The Company continues to believe that the Plavix patents are valid and infringed, and with Sanofi, is vigorously pursuing enforcement of their patent rights in Plavix. It is not possible at this time reasonably to assess the ultimate outcome of the ongoing patent litigation with Apotex, or of the other Plavix patent litigations, or the timing of any renewed generic competition for Plavix from Apotex or additional generic competition for Plavix from other third-party generic pharmaceutical companies. However, if Apotex were to prevail at trial, the Company would expect to face renewed generic competition for Plavix from Apotex promptly thereafter.

As previously disclosed, the Antitrust Division of the U.S. Department of Justice is conducting a criminal investigation regarding the proposed settlement of the pending patent Plavix litigation with Apotex. The Company is cooperating fully with the investigation. It is not possible at this time reasonably to assess the outcome of the investigation or its impact on the Company. It is also not possible at this time reasonably to assess the impact of the investigation, if any, on the Company's compliance with the Deferred Prosecution Agreement (DPA) with the U.S. Attorney's Office for the District of New Jersey (USAO). Also as previously disclosed, the USAO had initiated an investigation, conducted by the Monitor under the DPA (Monitor) and the USAO, into corporate governance issues relating to the Company's negotiations of the proposed settlement with Apotex, which included a review of whether there was any violation of Federal securities laws in connection with the proposed settlement with Apotex under the terms of the previously disclosed Consent Order the Company entered into with the U.S. Securities and Exchange Commission in August 2004 (Consent or SEC Consent). The Monitor has completed his investigation and submitted his report on the investigation to the USAO. The Monitor's report did not find any violation of the Consent or the Federal securities laws in connection with the proposed settlement. The Monitor concluded that the Company had violated certain paragraphs of the DPA related to governance matters. The violations cited by the Monitor in his report relate, among other things, to communication failures, including insufficient communications by the Company's former Chief Executive Officer (CEO) and former General Counsel with the Board of Directors (the Board) and with other members of senior management, as well as failure to comply with certain internal Company policies and procedures. The Monitor did not make any findings with respect to whether the Company knowingly and materially breached the DPA or make any recommendations. The USAO has advised the Company that he believes the matters cited in the Monitor's report have been fully remediated and, accordingly, that he does not intend to take any action under the DPA with respect to the Monitor's report.

For additional discussion of legal matters, including the Plavix patent litigation, the Antitrust Division investigation related to the proposed settlement with Apotex and the terms of the DPA and SEC Consent, see Note 21 "Legal Proceedings and Contingencies," "—OUTLOOK" and "—SEC Consent Order and Deferred Prosecution Agreement" below.

Business Environment

The Company conducts its business primarily within the pharmaceutical industry, which is highly competitive and subject to numerous government regulations. Many competitive factors may significantly affect the Company's sales of its products, including product efficacy, safety, price and cost-effectiveness, marketing effectiveness, product labeling, quality control and quality assurance of its manufacturing operations, and research and development of new products. To successfully compete for business in the health care industry, the Company must demonstrate that its products offer medical benefits as well as cost advantages. Currently, most of the Company's new product introductions compete with other products already on the market in the same therapeutic category, in addition to potential future competition of new products that competitors may introduce. The Company manufactures branded products, which are priced higher than generic products. Generic competition is one of the Company's leading challenges globally.

In the pharmaceutical industry, the majority of an innovative product's commercial value is usually realized during the period that the product has market exclusivity. When a product loses exclusivity, it is no longer protected by a patent and is subject to new competing products in the form of generic brands. Upon exclusivity loss, the Company can lose a major portion of that product's sales in a short period of time.

Both in the U.S. and internationally, the health care industry is subject to various government-imposed regulations that authorize prices or price controls that have and will continue to have an impact on the Company's sales. In the U.S., Congress and some state legislatures have considered a number of proposals and have enacted laws that could effect major changes in the health care system, either nationally or at the state level. Driven in part by budget concerns, Medicaid access and reimbursement restrictions have been implemented in some states and proposed in many others. In addition, in January 2006, the Medicare Prescription Drug Improvement and Modernization Act became effective and provides outpatient prescription drug coverage to senior citizens in the U.S. The Company is assessing the impact this legislation could have on its business, including a potential negative impact on the U.S. Pharmaceuticals business due to further legislative and/or regulatory changes that could result in additional pricing pressures or controls. In many markets outside the U.S., the Company operates in environments of government-mandated, cost-containment programs, or under other regulatory bodies or groups that can exert downward pressure on pricing. Pricing freedom is limited in the United Kingdom (UK), for instance, by the operation of a profit control plan, and in Germany by the operation of a reference price system. Companies also face significant delays in market access for new products. In some national markets, more than two years can elapse after drug approval before new medicines become available.

The growth of Managed Care Organizations (MCOs) in the U.S. has played a large role in the competition that surrounds the health care industry. MCOs seek to reduce health care expenditures for participants by making volume purchases and entering into long-term contracts to negotiate discounts with various pharmaceutical providers. Because of the market potential created by the large pool of participants, marketing prescription drugs to MCOs has become an important part of the Company's strategy. Companies compete for inclusion in a MCO formulary and the Company has generally been successful in having its major products included. The Company believes that developments in the managed care industry, including continued consolidation, have had and will continue to have a generally downward pressure on prices.

Pharmaceutical production processes are complex, highly regulated and vary widely from product to product. Shifting or adding manufacturing capacity can be a lengthy process requiring significant capital expenditures and regulatory approvals. Biologics manufacturing involves more complex processes than those of traditional pharmaceutical operations. As biologics become more important to the Company's product portfolio, the Company will continue to make arrangements with third-party manufacturers, and will make substantial investments to increase its internal capacity to produce biologics on a commercial scale, including building a new state-of-the-art manufacturing facility for the production of biologics in Devens, MA, with construction to commence in early 2007.

The Company has maintained a competitive position in the market and strives to uphold this position, which is dependent on its success in discovering and developing innovative, cost-effective products that serve unmet medical needs.

The Company and its subsidiaries are the subject of a number of significant pending lawsuits, claims, proceedings and investigations. It is not possible at this time reasonably to assess the final outcome of these investigations or litigations. Management continues to believe, as previously disclosed, that during the next few years, the aggregate impact, beyond current reserves, of these and other legal matters affecting the Company is reasonably likely to be material to the Company's results of operations and cash flows, and may be material to its financial condition and liquidity. For additional discussion of legal matters, see Note 21 "Legal Proceedings and Contingencies."

Strategy

The Company continues to execute its strategy for long-term growth and is currently on track with its strategic transition. This strategy consists of increasing investments behind growth brands and new specialty products, focusing the Company's research and development programs on products in the pharmaceutical pipeline in disease areas that address significant unmet medical needs, aligning sales and marketing emphasis on specialists and high value primary care prescribers, and implementing initiatives designed to achieve and maintain a more efficient cost base.

The Company's pharmaceutical portfolio has continued to transition away from products which have lost exclusivity towards growth drivers, recently launched and other products, which include Plavix, Abilify (aripiprazole), Avapro/Avalide (irbesartan/irbesartan-hydrochlorothiazide), *Reyataz* (atazanavir sulfate), the *Sustiva* (efavirenz) Franchise, Erbitux (cetuximab), *Orencia* (abatacept), *Baraclude* (entecavir) and *Sprycel* (dasatinib). U.S. net sales of these products accounted for 83% of the Company's U.S. pharmaceutical net sales in 2006, compared to 71% in 2005, while worldwide net sales of these products accounted for 59% of the Company's worldwide pharmaceutical net sales in 2006 as compared to 49% in 2005. The Company experienced the last of a series of major anticipated exclusivity losses in 2006, with the market exclusivity expiration of *Pravachol* (pravastatin sodium) in the U.S. and certain markets in Europe, and does not expect any significant new exclusivity losses for the next several years.

In order to support the production of the specialty products in the pharmaceutical portfolio including biologics, during 2006, the Board of Directors approved capital expenditures of approximately \$750 million for a bulk biologics manufacturing facility in the U.S. In February 2007, the Company completed the land purchase of an 89-acre site to locate its new large-scale, expandable multi-product bulk biologics manufacturing facility in Devens, MA. Construction is expected to begin in early 2007, and the facility is projected to be operationally complete in 2009. The Company expects to submit the site for regulatory approval in 2010. Commercial production of biologic compounds is anticipated to begin by 2011. In addition, the Company will expand its Manati, Puerto Rico facility, targeted for start-up in 2009. The expansion will add new space and renovate existing space for the filling and finishing of the Company's sterile products and biologic compounds, including *Orencia*, and several investigational compounds.

Given the Company's current limited capacity for commercial volumes of biologic products, the Company also received approval from the FDA in May 2006 that permits a third-party to manufacture *Orencia* at an additional facility. This facility, together with another third-party facility, which is pending submission to and approval from the FDA, will support increased production capacity necessary to meet expected long-term demand for *Orencia* and initial requirements for other biologics products if they are commercialized.

In keeping with its strategy, the Company invested \$3.1 billion in research and development in 2006, representing a 12% growth rate over 2005. Research and development dedicated to pharmaceutical products, including milestone payments for in-licensing and development programs, was \$2.8 billion compared to \$2.5 billion in 2005.

As part of its strategy, the Company is re-examining its operating costs to achieve and maintain a more efficient cost base. At the end of 2005, the Company launched an initiative to identify and realize productivity savings. Through this initiative the Company has re-examined its operating model to focus resources on high value priorities; simplify and streamline business processes; improve governance and decision making; and build the capabilities to sustain these cost reductions for the long term. The Company is on plan to achieve the goal of realizing a minimum of \$500 million in productivity savings in 2007 and an incremental \$100 million in 2008, as well as making the Company more productive, efficient and effective.

New Product and Pipeline Developments

In January 2007, the Company and AstraZeneca PLC (AstraZeneca) announced a collaboration to develop and commercialize two investigational compounds, saxagliptin and dapagliflozin, being studied for the treatment of type 2 diabetes. The Company discovered both compounds. The collaboration on these compounds is worldwide, except for Japan. Separately, the Company also announced a collaboration with Otsuka Pharmaceutical Co., Ltd. (Otsuka) to develop saxagliptin in Japan.

In November 2006, the FDA granted Fast Track designation for ipilimumab used in combination with chemotherapy (dacarbazine) in previously untreated metastatic melanoma patients. The FDA also granted Fast Track designation for ipilimumab used as a monotherapy in previously treated metastatic melanoma patients.

In October 2006, the Company moved its investigational anti-thrombosis compound apixaban into Phase III development. Apixaban is an oral direct factor Xa inhibitor.

In October 2006, the Company received FDA approval of a new once-daily 300 mg single capsule formulation of *Reyataz* for the treatment of human immunodeficiency virus (HIV)-1 infection in adults as part of a combination therapy, which can replace two

Reyataz 150 mg capsules in appropriate patients. The Company now has one-pill, once-daily HIV medicine options available in three drug classes as part of a combination therapy.

The Company and Otsuka received approval from the FDA in September 2006 and the European Medicines Evaluation Agency (EMA) in October 2006 for Abilify Injection, the first ready-to-use single-dose vial of an atypical antipsychotic to control agitation in adults with schizophrenia and bipolar mania.

In August 2006, the Company and Sanofi received approval from both the FDA and the EMA for an additional indication for Plavix to reduce the rate of death from any cause and the rate of a combined endpoint of re-infarction, stroke or death in patients with acute ST-segment elevation myocardial infarction.

In July 2006, Atripla, the first-ever once-daily single tablet three-drug regimen for HIV intended as a stand-alone therapy or in combination with other antiretrovirals, received approval from the FDA. The product combines *Sustiva* (efavirenz), manufactured by the Company and Truvada (emtricitabine and tenofovir disoproxil fumarate), manufactured by Gilead. The Company, Gilead and Merck & Co., Inc. submitted a Marketing Authorization Approval for Atripla to the EMA in October 2006. In addition, the Company and Gilead submitted Atripla for regulatory approval in Canada in September 2006.

In June 2006, the Company received approval for *Sprycel* (dasatinib) from the FDA for the treatment of adults with chronic, accelerated, or myeloid or lymphoid blast phase chronic myeloid leukemia or Philadelphia chromosome-positive acute lymphoblastic leukemia (Ph+ALL) with resistance or intolerance to prior therapy, including Gleevec (imatinib mesylate). *Sprycel* was launched in the U.S. in July 2006. In November 2006, the Company also received approval of *Sprycel* from the Committee for Medicinal Products for Human Use of the EMA. The product was launched in Austria, Germany, France, Finland, Sweden and the UK. In February 2007, the Company received approval for *Sprycel*, without the Ph+ALL indication, in Switzerland.

In April 2006, the Company launched EMSAM (selegiline transdermal system) in the U.S. EMSAM is the first transdermal patch for the delivery of a monoamine oxidase inhibitor for the treatment of major depressive disorder in adults. EMSAM was developed by Somerset Pharmaceuticals, Inc., a joint venture between Mylan Laboratories, Inc. (Mylan) and Watson Pharmaceuticals, Inc. (Watson). The Company has obtained exclusive distribution rights to commercialize EMSAM in the U.S. and Canada and markets EMSAM through its existing neuroscience sales force.

In March 2006, the FDA approved Erbitux, which is co-promoted by the Company and ImClone Systems Incorporated (ImClone), for use in the treatment of squamous cell carcinoma of the head and neck. Erbitux had previously been indicated for the treatment of metastatic colorectal cancer.

In February 2006, the Company launched *Baraclude*, its treatment for hepatitis B, in China. The Company also launched *Baraclude* in several new markets during the third quarter of 2006, including Germany, France, the UK and Japan. *Baraclude* is approved in more than 50 countries and regions worldwide.

In February 2006, the Company launched *Orencia*, its treatment for signs and symptoms of rheumatoid arthritis, in the U.S. after receiving approval from the FDA in December 2005. In June 2006, the Company received approval of *Orencia* in Canada and launched the product in August 2006.

OUTLOOK

For 2007, the Company expects reductions of net sales for products that have lost exclusivity in previous years to range between \$0.9 billion and \$1.0 billion, as compared to \$1.4 billion in 2006, and \$1.3 billion in 2005. While the Company expects generic clopidogrel bisulfate inventory in the market to have a continued residual impact on 2007 Plavix net sales, the Company does expect Plavix net sales and earnings growth in 2007, assuming the absence of renewed or additional generic competition. The Company expects increased prescription demand for Plavix as well as for other key brands and newly launched products. Compared to 2006, gross margin is expected to improve due to growth of higher margin products, lower margin erosion related to exclusivity losses, and improved manufacturing efficiencies. Marketing, selling and administrative expense is expected to remain relatively unchanged as efficiency savings should largely offset inflationary cost increases, and as the Company continues to focus on high value primary care and specialist physicians and implements various productivity initiatives. The Company expects to continue to increase investments to develop additional new compounds and support the introduction of new products.

The Company and its subsidiaries are the subject of a number of significant pending lawsuits, claims, proceedings and investigations including the pending Plavix litigation, described below. There can be no assurance that there will not be an increase in the scope of these matters or that any future lawsuits, claims and proceedings will not be material to the Company. In addition, there is an increasing trend by foreign governments to scrutinize sales and marketing activities of pharmaceutical companies and there can be no assurance that any such investigations or any other investigations will not be material. It is not possible at this time reasonably

to assess the final outcome of these investigations or litigations. Management continues to believe, as previously disclosed, that during the next few years, the aggregate impact, beyond current reserves, of the pending Plavix patent litigation, these other litigations and investigations and other legal matters affecting the Company is reasonably likely to be material to the Company's results of operations and cash flows, and may be material to its financial condition and liquidity. The Company's expectations for the next several years described above do not reflect the potential impact of litigation on the Company's results of operations.

As previously disclosed, the composition of matter patent for Plavix, which expires in 2011, is subject to litigation in the U.S. with Apotex. The trial in the underlying patent litigation ended on February 15, 2007 and the Court is expected to rule following post-trial briefing. If Apotex were to prevail in the trial in the patent litigation, the Company would expect to face renewed generic competition for Plavix promptly thereafter. There are other pending Plavix patent litigations in the U.S. and in other less significant markets for the product. In the U.S., the Company's U.S. territory partnership under its alliance with Sanofi is a plaintiff in three additional pending patent infringement lawsuits against Dr. Reddy's, Teva and Cobalt, all related to the '265 Patent. Each of Dr. Reddy's and Teva have filed an aNDA with the FDA, and all exclusivity periods and statutory stay periods under the Hatch-Waxman Act have expired, with the exception of the 30-month stay that applies to Teva, which expires on February 27, 2007. Accordingly, final approval by the FDA would provide each company authorization to distribute a generic clopidogrel bisulfate product in the U.S., although such a launch at this point in time would be at-risk of an adverse damages award should the Companies prevail in the underlying patent litigation. The Company continues to believe that the Plavix patents are valid and infringed, and with Sanofi, is vigorously pursuing these cases.

It is not possible at this time reasonably to assess the ultimate outcome of the patent litigation with Apotex or of the other Plavix patent litigations, or the timing of any renewed generic competition for Plavix from Apotex or additional generic competition for Plavix from other generic pharmaceutical companies. Loss of market exclusivity of Plavix and/or the development of sustained generic competition would be material to the Company's sales of Plavix, results of operations and cash flows, and could be material to the Company's financial condition and liquidity. Plavix is the Company's largest product by net sales, and U.S. net sales for Plavix were \$2.7 billion, \$3.2 billion and \$2.8 billion in 2006, 2005 and 2004, respectively.

As previously disclosed, the Antitrust Division of the U.S. Department of Justice is conducting a criminal investigation regarding the proposed settlement of the pending Plavix patent litigation with Apotex. The Company is cooperating fully with the investigation. It is not possible at this time reasonably to assess the outcome of the investigation or its impact on the Company. It is also not possible at this time reasonably to assess the impact of the investigation, if any, on the Company's compliance with the DPA with the USAO. Also as previously disclosed, the USAO had initiated an investigation conducted by the Monitor under the DPA and the USAO, into the Company's negotiations of the proposed settlement with Apotex, which included a review of corporate governance issues and whether there was any violation of Federal securities laws in connection with the proposed settlement with Apotex under the terms of the previously disclosed Consent that the Company entered into with the Securities Exchange Commission (SEC). The Monitor has completed his investigation and submitted his report on the investigation to the USAO. The Monitor's report did not find any violation of the Consent or the Federal securities laws in connection with the proposed settlement. The Monitor concluded that the Company had violated certain paragraphs of the DPA related to governance matters. The violations cited by the Monitor in his report relate, among other things, to communication failures, including insufficient communications by the Company's former CEO and former General Counsel with the Board and with other members of senior management, as well as failure to comply with certain internal Company policies and procedures. The Monitor did not make any findings with respect to whether the Company knowingly and materially breached the DPA or make any recommendations. The USAO has advised the Company that he believes the matters cited in the Monitor's report have been fully remediated and, accordingly, that he does not intend to take any action under the DPA with respect to the Monitor's report.

For additional discussion of legal matters, including the Plavix patent litigation, the Antitrust Division investigation related to the proposed settlement with Apotex and the terms of the DPA and SEC Consent, see “—Executive Summary—Plavix” above, “—SEC Consent Order and Deferred Prosecution Agreement” below and Note 21 “Legal Proceedings and Contingencies.”

RESULTS OF OPERATIONS

The following discussions of the Company's results of continuing operations exclude the results related to the Oncology Therapeutics Network (OTN) business, which were previously presented as a separate segment prior to its divestiture in 2005, and have been segregated from continuing operations and reflected as discontinued operations for all periods presented. See "— Discontinued Operations" below. The Company's results of operations were as follows:

Dollars in Millions	2006	2005	2004	% Change	
				2006 vs. 2005	2005 vs. 2004
Net Sales	\$ 17,914	\$ 19,207	\$ 19,380	(7)%	(1)%
Earnings from Continuing Operations Before Minority Interest and Income Taxes	\$ 2,635	\$ 4,516	\$ 4,418	(42)%	2%
<i>% of net sales</i>	14.7%	23.5%	22.8%		
Provision for Income Taxes	\$ 610	\$ 932	\$ 1,519	(35)%	(39)%
<i>Effective tax rate</i>	23.2%	20.6%	34.4%		
Earnings from Continuing Operations	\$ 1,585	\$ 2,992	\$ 2,378	(47)%	26%
<i>% of net sales</i>	8.8%	15.6%	12.3%		

Net Sales

Net sales from continuing operations for 2006 decreased 7% to \$17.9 billion compared to 2005. U.S. net sales in 2006 decreased 7% to \$9.7 billion compared to 2005. International net sales in 2006 decreased 6% to \$8.2 billion compared to 2005, including a 1% favorable foreign exchange impact.

In 2005, net sales from continuing operations decreased 1% to \$19.2 billion compared to 2004. U.S. net sales in 2005 decreased 1% to \$10.5 billion compared to 2004, while international net sales of \$8.7 billion remained relatively constant in 2005 as compared to 2004, including a 2% favorable foreign exchange impact.

The changes in net sales were as follows:

	Total Change	Analysis of % Change		
		Volume	Price	Foreign Exchange
2006 vs. 2005	(7)%	(9)%	2%	—
2005 vs. 2004	(1)%	(2)%	—	1%

In general, the Company's business is not seasonal. For information on U.S. pharmaceutical prescriber demand, reference is made to the table within Business Segments under the Pharmaceuticals section below, which sets forth a comparison of changes in net sales to the estimated total prescription growth (for both retail and mail order customers) for certain of the Company's top 15 pharmaceutical products and products that the Company views as current and future growth drivers sold within the U.S.

The Company operates in three reportable segments—Pharmaceuticals, Nutritionals and Other Health Care. In May 2005, the Company completed the sale of OTN, which was previously presented as a separate segment. As such, the results of operations for OTN are presented as part of the Company's results from discontinued operations in accordance with Statement of Financial Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Accordingly, OTN results of operations in prior periods have been reclassified to discontinued operations to conform with current year presentations. The Company's net sales by segment were as follows:

Dollars in Millions	Net Sales			% Change	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Pharmaceuticals	\$ 13,861	\$ 15,254	\$ 15,564	(9)%	(2)%
<i>% of net sales</i>	77%	79%	80%		
Nutritionals	2,347	2,205	2,001	6%	10%
<i>% of net sales</i>	13%	12%	10%		
Other Health Care	1,706	1,748	1,815	(2)%	(4)%
<i>% of net sales</i>	10%	9%	10%		
Health Care Group	4,053	3,953	3,816	3%	4%
Total	\$ 17,914	\$ 19,207	\$ 19,380	(7)%	(1)%

The Company recognizes revenue net of various sales adjustments to arrive at net sales as reported on the Consolidated Statement of Earnings. These adjustments are referred to as gross-to-net sales adjustments and are further described in “—Critical Accounting Policies” below. The reconciliations of the Company’s gross sales to net sales by each significant category of gross-to-net sales adjustments were as follows:

Dollars in Millions	For the Years Ended December 31		
	2006	2005	2004
Gross Sales	\$ 20,804	\$ 23,003	\$ 23,896
Gross-to-Net Sales Adjustments			
Prime Vendor Charge-Backs	(703)	(1,090)	(1,319)
Women, Infants and Children (WIC) Rebates	(872)	(843)	(846)
Managed Health Care Rebates and Other Contract Discounts	(348)	(514)	(660)
Medicaid Rebates	(174)	(595)	(673)
Cash Discounts	(224)	(271)	(311)
Sales Returns	(230)	(164)	(276)
Other Adjustments	(339)	(319)	(431)
Total Gross-to-Net Sales Adjustments	(2,890)	(3,796)	(4,516)
Net Sales	\$ 17,914	\$ 19,207	\$ 19,380

The decrease in gross-to-net sales adjustments in 2006 compared to 2005 was affected by a number of factors, including changes in customer mix and a portfolio shift in each case towards products that required lower rebates, as well as changes in contract status. The decrease in prime vendor charge-backs was primarily the result of lower Plavix net sales, volume erosion on highly rebated *Paraplatin* (carboplatin) and *TAXOL*[®] (paclitaxel) due to generic competition, as well as the impact from the discontinued commercialization of *Tequin* (gatifloxacin). Managed health care rebates and other contract discounts decreased primarily as a result of the reversal of reserves related to the TRICARE Retail Pharmacy Refund Program, as well as the exclusivity loss of *Pravachol*, which also reduced Medicaid rebates. In addition, lower Plavix net sales and the shift in patient enrollment from Medicaid to Medicare under Medicare Part D, resulted in a decrease in Medicaid rebates, partially offset by a corresponding increase in managed health care rebates. The decrease in cash discounts was primarily due to the exclusivity loss of *Pravachol* and lower Plavix sales volumes. The increase in sales returns was primarily due to higher return trends for non-exclusive brands as well as from the discontinued commercialization of *Tequin*.

In 2005, the decrease from 2004 for prime vendor charge-backs and managed health care rebates was primarily due to lower relative sales volume in this segment related to product mix. The decrease in sales returns was primarily due to lower returns for certain products including *Tequin*, *Pravachol* and *Sustiva*. The decrease in other adjustments was due to lower sales discounts and government rebates in the international businesses.

The activities and ending balances of each significant category of gross-to-net sales adjustments were as follows:

Dollars in Millions	Prime Vendor Charge-Backs	Women, Infants and Children (WIC) Rebates	Managed Health Care Rebates and Other Contract Discounts	Medicaid Rebates	Cash Discounts	Sales Returns	Other Adjustments	Total
Balance at January 1, 2005	\$ 106	\$ 234	\$ 198	\$ 372	\$ 33	\$ 229	\$ 176	\$ 1,348
Provision related to sales made in current period	1,096	843	509	558	269	191	351	3,817
Provision related to sales made in prior periods	(6)	—	5	37	2	(27)	(32)	(21)
Returns and payments	(1,089)	(825)	(542)	(641)	(278)	(206)	(364)	(3,945)
Impact of foreign currency translation	—	—	(3)	—	—	(2)	(7)	(12)
Balance at December 31, 2005	107	252	167	326	26	185	124	1,187
Provision related to sales made in current period	706	867	381	174	221	200	348	2,897
Provision related to sales made in prior periods	(3)	5	(33)	—	3	30	(9)	(7)
Returns and payments	(747)	(894)	(405)	(363)	(232)	(196)	(343)	(3,180)
Impact of foreign currency translation	—	—	1	—	—	2	4	7
Balance at December 31, 2006	\$ 63	\$ 230	\$ 111	\$ 137	\$ 18	\$ 221	\$ 124	\$ 904

In 2006, the Company recorded gross-to-net sales adjustments related to sales made in prior periods. The significant items included charges for sales returns of \$30 million primarily related to higher than expected return trends for certain non-exclusive products, as well as from the discontinued commercialization of *Tequin*; and credits in other contract discounts of \$33 million, primarily due to the reversal of reserves related to the TRICARE Retail Pharmacy Refund Program.

In 2005, the significant items included charges of \$37 million for Medicaid rebates, primarily as a result of higher than expected Medicaid utilization of various products; credits of \$32 million for other adjustments, primarily as a result of lower than expected rebates to foreign governments; and credits of \$27 million for sales returns resulting from lower returns for certain products including *Tequin*, *Avapro/Avalide* and *Plavix*.

No other significant revisions were made to the estimates for gross-to-net sales adjustments in 2006 and 2005.

Pharmaceuticals

The changes in pharmaceutical sales were as follows:

	Total Change	Analysis of % Change		
		Volume	Price	Foreign Exchange
2006 vs. 2005	(9)%	(11)%	2%	—
2005 vs. 2004	(2)%	(3)%	—	1%

In 2006, Worldwide Pharmaceuticals sales decreased 9% to \$13,861 million. U.S. Pharmaceuticals sales decreased 9% to \$7,417 million from \$8,190 million in 2005, primarily due to lower sales of *Plavix* resulting from the at-risk launch of generic clopidogrel bisulfate in August 2006 and loss of exclusivity of *Pravachol* offset by continued growth of *Abilify*, *Erbix*, *Reyataz*, the *Sustiva* Franchise and *Avapro/Avalide*, and sales of newer products including *Orencia*, *Baraclude* and *Sprycel*. In aggregate, estimated U.S. wholesaler inventory levels of the Company's key pharmaceutical products sold by the U.S. Pharmaceuticals business at the end of 2006 were approximately two and a half weeks.

International Pharmaceuticals sales decreased 9% to \$6,444 million in 2006 from \$7,064 million in 2005, primarily due to a decline in *Pravachol* and *TAXOL*[®] (paclitaxel) sales resulting from increased generic competition in Europe, partially offset by increased sales of newer products including *Reyataz*, *Abilify* and *Baraclude*.

In 2005, Worldwide Pharmaceuticals sales decreased 2% to \$15,254 million. U.S. Pharmaceuticals sales in 2005 decreased 3% to \$8,190 million compared to \$8,446 million in 2004, primarily due to the continued impact of exclusivity losses of *Paraplatin* and the *Glucophage* Franchise and increased competition for *Pravachol*, partially offset by increased sales of growth drivers including *Plavix*, *Abilify*, *Erbix* and *Reyataz*. In aggregate, estimated wholesaler inventory levels of the Company's key pharmaceutical

products sold by the U.S. Pharmaceuticals business at the end of 2005 were down from the end of 2004 by approximately three-tenths of a month to approximately two and a half weeks. The decline in inventory levels negatively impacted the sales performance of certain products in 2005.

International Pharmaceuticals sales in 2005 decreased 1%, including a 1% favorable foreign exchange impact to \$7,064 million, primarily due to increased generic competition for *Pravachol* and *TAXOL*[®] (paclitaxel), partially offset by increased sales of newer products including *Reyataz* and *Abilify*, as well as growth of *Plavix*.

Key pharmaceutical products and their sales, representing 78%, 77% and 71% of total pharmaceutical sales in 2006, 2005 and 2004, respectively, were as follows:

Dollars in Millions	2006	2005	2004	% Change	
				2006 vs. 2005	2005 vs. 2004
Cardiovascular					
Plavix	\$ 3,257	\$ 3,823	\$ 3,327	(15)%	15%
<i>Pravachol</i>	1,197	2,256	2,635	(47)%	(14)%
Avapro/Avalide	1,097	982	930	12%	6%
<i>Coumadin</i>	220	212	255	4%	(17)%
<i>Monopril</i>	159	208	274	(24)%	(24)%
Virology					
<i>Reyataz</i>	931	696	414	34%	68%
<i>Sustiva</i> Franchise (total revenue)	791	680	621	16%	10%
<i>Zerit</i>	155	216	272	(28)%	(21)%
<i>Baraclude</i>	83	12	—	**	—
Other Infectious Diseases					
<i>Cefzil</i>	87	259	270	(66)%	(4)%
Oncology					
Erbitux	652	413	261	58%	58%
<i>TAXOL</i> [®] (paclitaxel)	563	747	991	(25)%	(25)%
<i>Sprycel</i>	25	—	—	—	—
Affective (Psychiatric) Disorders					
<i>Abilify</i> (total revenue)	1,282	912	593	41%	54%
EMSAM	18	—	—	—	—
Immunoscience					
<i>Orencia</i>	89	—	—	—	—
Other Pharmaceuticals					
<i>Effergan</i>	266	283	274	(6)%	3%

** Change is in excess of 200%.

- Sales of *Plavix*, a platelet aggregation inhibitor that is part of the Company's alliance with Sanofi, decreased 15% to \$3,257 million in 2006 from 2005. Sales of *Plavix* decreased 18% in the U.S. in 2006 to \$2,655 million from 2005, primarily as a result of the launch of a generic clopidogrel bisulfate product in August 2006. While market exclusivity for *Plavix* is expected to expire in 2011 in the U.S. and 2013 in the major European markets, the composition of matter patent for *Plavix* is the subject of litigation, including the litigation with Apotex as noted above. The trial in the underlying patent litigation ended on February 15, 2007 and the Court will rule following post-trial briefing. If Apotex were to prevail at trial in the underlying patent litigation or if there is additional competition for *Plavix* from other third-party generic pharmaceutical companies, *Plavix* would face renewed generic competition. In 2005, sales increased 15%, including a 1% favorable foreign exchange impact, to \$3,823 million from \$3,327 million in 2004. U.S. sales increased 14% to \$3,235 million in 2005 from \$2,833 million in 2004, primarily due to increased demand. For additional information on the *Plavix* litigations, as well as the generic launch by Apotex, see “—Executive Summary—*Plavix*” above and Note 21 “Legal Proceedings and Contingencies.”
- Sales of *Pravachol*, an HMG Co-A reductase inhibitor, decreased 47%, including a 1% unfavorable foreign exchange impact, to \$1,197 million in 2006 from 2005, due to market exclusivity expiration in April 2006 resulting in generic competition for most product strengths in the U.S. and generic competition in key European markets. Estimated total U.S. prescription demand decreased approximately 59% compared to 2005. In 2005, sales of *Pravachol* decreased 14% to \$2,256 million from \$2,635 million in 2004, primarily due to lower demand resulting from increased competition and the related reduction in wholesaler inventory levels, partially offset by lower managed health care rebates in 2005. Market exclusivity in the European Union (EU) ended in 2004, with the exception of Sweden, where expiration occurred in March 2006, Italy, where expiration will occur in

January 2008, and France, where generic competition that was not authorized by the Company commenced in July 2006. As previously disclosed, the Company authorized Watson to distribute pravastatin sodium tablets in the U.S.

- Sales of *Avapro/Avalide*, an angiotensin II receptor blocker for the treatment of hypertension that is also part of the Sanofi alliance, increased 12%, including a 1% favorable foreign exchange impact, to \$1,097 million in 2006 from 2005. U.S. sales increased 13% to \$647 million in 2006 compared to 2005, primarily due to higher average net selling prices and higher volume. Estimated total U.S. prescription demand increased approximately 4% compared to 2005. International sales increased 10%, including a 2% favorable foreign exchange impact, to \$450 million compared to 2005. In 2005, sales increased 6%, including a 1% favorable foreign exchange impact, to \$982 million from \$930 million in 2004. U.S. sales increased 2% to \$574 million in 2005 compared to \$562 million in 2004, while international sales increased 11%, including a 3% favorable foreign exchange impact, to \$408 million from \$368 million in 2004, primarily due to increased sales in Canada, France and Germany. Market exclusivity for *Avapro/Avalide* (known in the EU as *Aprovel/Karvea*) is expected to expire in 2012 (including pediatric extension) in the U.S. and in countries in the EU; *Avapro/Avalide* is not currently marketed in Japan.
- Sales of *Coumadin* (warfarin sodium), an oral anti-coagulant used predominantly in patients with atrial fibrillation or deep venous thrombosis/pulmonary embolism, increased 4% to \$220 million in 2006 compared to 2005, primarily due to higher average net selling prices, partially offset by lower demand driven by continued competition. Estimated total U.S. prescription demand decreased approximately 21% compared to 2005. Sales in 2005 decreased 17% to \$212 million from \$255 million in 2004, due to continued competition. Market exclusivity for *Coumadin* expired in the U.S. in 1997.
- Sales of *Monopril*, a second generation angiotensin converting enzyme inhibitor for the treatment of hypertension, sold almost exclusively in non-U.S. markets, decreased 24% to \$159 million in 2006. Sales in 2005 were \$208 million, a decrease of 24%, including a 2% favorable foreign exchange impact, from \$274 million in 2004. The sales declines in both years were due to product supply issues in key European markets. Market exclusivity protection for *Monopril* expired in 2003 in the U.S. and has expired or is expected to expire between 2001 and 2008 in countries in the EU. *Monopril* is not currently marketed in Japan.
- Sales of *Reyataz*, a protease inhibitor for the treatment of HIV, increased 34%, including a 1% favorable foreign exchange impact, to \$931 million in 2006, primarily due to increased demand in the U.S., Europe and Latin America. Estimated total U.S. prescription demand increased approximately 18% compared to 2005. U.S. sales increased 27% to \$514 million in 2006 from \$405 million in 2005, primarily due to higher demand and higher average net selling prices. International sales increased 43%, including a 1% favorable foreign exchange impact, to \$417 million in 2006 compared to 2005. Sales in 2005 were \$696 million compared to \$414 million in 2004, primarily due to increased demand in the U.S. and in Europe, where *Reyataz* was launched in the second quarter of 2004. Market exclusivity for *Reyataz* is expected to expire in 2017 in the U.S., in countries in the EU and Japan.
- Total revenue for the *Sustiva* Franchise, a non-nucleoside reverse transcriptase inhibitor for the treatment of HIV, increased 16%, including a 1% favorable foreign exchange impact, to \$791 million in 2006 from 2005 due to higher demand and the launch of *Atripla* in the third quarter of 2006. Estimated total U.S. prescription demand for the *Sustiva* Franchise increased approximately 11% compared to 2005. In July 2006, the Company and Gilead launched *Atripla*, a once-daily single tablet three-drug regimen for HIV intended as a stand-alone therapy or in combination with other antiretrovirals. Total revenue for the *Sustiva* Franchise includes sales of *Sustiva*, as well as revenue from bulk efavirenz included in the combination therapy *Atripla*. The Company records revenue for the bulk efavirenz component of *Atripla* upon sales of *Atripla* by the Gilead joint venture to third-party customers. In 2005, *Sustiva* sales increased 10% to \$680 million from \$621 million in 2004, primarily due to increased demand, higher average selling prices and lower sales returns. Market exclusivity for *Sustiva* is expected to expire in 2013 in the U.S. and in countries in the EU; the Company does not, but others do, market *Sustiva* in Japan. For additional information on revenue recognition of the *Sustiva* Franchise, see Note 2 "Alliances and Investments."
- Sales of *Zerit* (stavudine), an antiretroviral agent used in the treatment of HIV, decreased 28% to \$155 million in 2006, primarily as a result of lower demand in both the U.S. and Europe. Estimated total U.S. prescription demand decreased approximately 30% compared to 2005. In 2005, *Zerit* sales decreased 21%, including a 1% favorable foreign exchange impact, to \$216 million from \$272 million in 2004, primarily as a result of a decrease in demand in the U.S. Market exclusivity protection for *Zerit* is expected to expire in 2008 in the U.S., between 2007 and 2011 in countries in the EU and in 2008 in Japan.
- Sales of *Baraclude*, an oral antiviral agent for the treatment of chronic hepatitis B, increased to \$83 million in 2006 compared to \$12 million in 2005. *Baraclude* was launched in the U.S. in April 2005, in China in February 2006, in the UK and Germany in July 2006 and in France and Japan in September 2006. The Company has a composition of matter patent that expires in the U.S. in 2010 and in Germany, France and the UK in 2011.

- Sales of *Cefzil*, an antibiotic for the treatment of mild to moderately severe bacterial infections, decreased 66% to \$87 million in 2006 from 2005, primarily due to generic competition in the U.S. In 2006, estimated total U.S. prescription demand decreased approximately 91% compared to 2005. In 2005, *Cefzil* sales decreased 4%, including a 1% favorable foreign exchange impact, to \$259 million from \$270 million in 2004, primarily due to lower demand. Market exclusivity expired in December 2005 in the U.S. and is expected to expire between 2007 and 2009 in the EU.
- Sales of Erbitux, which is sold by the Company almost exclusively in the U.S., increased 58% to \$652 million in 2006 from \$413 million in 2005, driven by continued growth related to usage in the treatment of colorectal cancer and for the treatment of head and neck cancer, a new indication approved by the FDA in March 2006. Sales in 2005 increased to \$413 million from \$261 million in 2004. Erbitux is marketed by the Company under a distribution and copromotion agreement with ImClone. A use patent relating to combination therapy with cytotoxic treatments expires in 2017. There is no patent covering monotherapy. Currently, generic versions of biologic products cannot be approved under U.S. law. However, the law could change in the future. Even in the absence of new legislation, the FDA is taking steps toward allowing generic versions of certain biologics. Competitors seeking approval of biologic products must file their own safety and efficacy data, and address the challenges of biologics manufacturing, which involves more complex processes and are more costly than those of traditional pharmaceutical operations. The Company's right to market Erbitux in North America and Japan under its agreement with ImClone expires in September 2018. The Company does not, but others do, market Erbitux in countries in the EU. As previously disclosed, ImClone and Yeda Research and Development Company Ltd. (Yeda) have been in litigation over the ownership of the use patent for combination therapy with cytotoxic treatments relating to Erbitux. In September 2006, the court granted Yeda the complete ownership of that patent. ImClone has appealed the court's decision. For further information pertaining to legal proceedings involving Erbitux, see Note 2 "Alliances and Investments." And Note 21 "Legal Proceedings and Contingencies."
- Sales of *TAXOL*[®] (paclitaxel), an anti-cancer agent sold almost exclusively in the non-U.S. markets, were \$563 million in 2006 compared to \$747 million in 2005. Sales of *TAXOL*[®] (paclitaxel) decreased 25%, including a 2% unfavorable foreign exchange impact, primarily due to increased generic competition in Europe and generic entry in Japan during the third quarter of 2006. In 2005, *TAXOL*[®] (paclitaxel) sales decreased 25%, including a 1% unfavorable foreign exchange impact, to \$747 million from \$991 million in 2004, primarily as a result of increased generic competition in Europe. Market exclusivity protection for *TAXOL*[®] (paclitaxel) expired in 2000 in the U.S. and in 2003 in countries in the EU. Two generic paclitaxel products have received regulatory approval in Japan, and one generic product has entered the market.
- *Sprycel*, an oral inhibitor of multiple tyrosine kinases for the treatment of adults with chronic, accelerated, or myeloid or lymphoid blast phase chronic myeloid leukemia with resistance or intolerance to prior therapy including Gleevec (imatinib mesylate), was launched in the U.S. in July 2006 and in certain European markets in the fourth quarter of 2006. Sales for 2006 were \$25 million. Market exclusivity for *Sprycel* is expected to expire in 2020 in the U.S.
- Total revenue for Abilify, an antipsychotic agent for the treatment of schizophrenia, acute bipolar mania and bipolar disorder, increased 41% to \$1,282 million in 2006 from 2005. U.S. sales increased 40% to \$1,052 million in 2006 from \$750 million in 2005, primarily due to higher demand and higher average net selling prices. Estimated total U.S. prescription demand increased approximately 21% compared to 2005. In 2005, total revenue for Abilify was \$912 million, compared to \$593 million in 2004, primarily due to demand growth in the U.S. and the continued growth in Europe, which achieved sales of \$140 million in 2005. Total revenue for Abilify primarily consists of alliance revenue representing the Company's 65% share of net sales in countries where it copromotes with Otsuka and the product is sold by an Otsuka affiliate as a distributor. Otsuka's market exclusivity protection for Abilify is expected to expire in 2014 in the U.S. (including the granted patent term extension). Otsuka has received formal notices from six generic pharmaceutical companies stating that each has filed an aNDA with the FDA for various dosage forms of aripiprazole, which the Company and Otsuka comarket in the U.S. as Abilify. Each of these notices further states that its aNDA contains a p(IV) certification directed to U.S. Patent No. 5,006,528 (the '528 Patent), which covers aripiprazole and expires in October 2014. In addition, each of the notices purports to provide Otsuka with the respective p(IV) certification. These certifications contain various allegations regarding the enforceability of the '528 Patent and/or the validity and/or infringement of some or all of the claims therein. Otsuka has sole rights to enforce the '528 Patent. The Company also has the right to copromote Abilify in several European countries (the UK, France, Germany and Spain) and to act as exclusive distributor for the product in the rest of the EU. A composition of matter patent is in force in Germany, the UK, France, Italy, the Netherlands, Romania, Sweden, Switzerland, Spain and Denmark. The original expiration date of 2009 has been extended to 2014 by grant of a supplemental protection certificate in all of the above countries except Romania and Denmark. Data exclusivity in the EU expires in 2014. The Company's contractual right to market Abilify expires in November 2012 in the U.S. and Puerto Rico and, for the countries in the EU where the Company has the exclusive right to market Abilify until June 2014. For additional information on revenue recognition of Abilify, see Note 2 "Alliances and Investments."

- EMSAM, a transdermal patch for the delivery of a monoamine oxidase inhibitor for the treatment of major depressive disorder in adults, was launched in the U.S. in April 2006. Sales in 2006 were \$18 million. In the third quarter of 2006, as a result of lower than expected sales for EMSAM, the Company recorded a \$27 million impairment charge for EMSAM related assets. EMSAM was developed by Somerset, a joint venture between Mylan and Watson. The Company has obtained exclusive distribution rights to commercialize EMSAM in the U.S. and Canada and markets EMSAM in the U.S. through its existing neuroscience sales force. As a new drug formulation, EMSAM received three years of Hatch-Waxman data exclusivity, which expires in 2009 in the U.S.
- *Orencia*, a fusion protein indicated for adult patients with moderate to severe rheumatoid arthritis who have had an inadequate response to one or more currently available treatments such as methotrexate or anti-tumor necrosis factor therapy, was launched in the U.S. in February 2006. Sales in 2006 were \$89 million, substantially all in the U.S. The Company has a composition of matter patent that expires in the U.S. in 2016 and the patent may be eligible for patent term restoration, which could possibly extend the term. As noted above, generic versions of biologic products cannot be approved under U.S. law, but the law could change in the future.
- Sales of *Effergan* (paracetamol), a formulation of acetaminophen for pain relief sold principally in Europe, decreased 6% to \$266 million in 2006, primarily due to a change in government reimbursement. In 2005, sales increased 3%, including a 1% favorable foreign exchange impact, to \$283 million from \$274 million in 2004, primarily due to increased sales in Italy and Spain as a result of a strong flu season in 2005.

The estimated U.S. prescription change data provided above includes information only from the retail and mail order channels and does not reflect information from other channels, such as hospitals, institutions and long-term care, among others. The estimated prescription and prescription change data are based on National Prescription Audit (NPA) data provided by IMS Health (IMS), a supplier of market research for the pharmaceutical industry, as described below.

In most instances, the basic exclusivity loss date indicated above is the expiration date of the patent that claims the active ingredient of the drug or the method of using the drug for the approved indication. In some instances, the basic exclusivity loss date indicated is the expiration date of the data exclusivity period. In situations where there is only data exclusivity without patent protection, a competitor could seek regulatory approval prior to the expiration of the data exclusivity period by submitting its own clinical trial data to obtain marketing approval. The Company assesses the market exclusivity period for each of its products on a case-by-case basis. The length of market exclusivity for any of the Company's products is difficult to predict with certainty because of the complex interaction between patent and regulatory forms of exclusivity and other factors. There can be no assurance that a particular product will enjoy market exclusivity for the full period of time that the Company currently anticipates. The estimates of market exclusivities reported above are for business planning purposes only and are not intended to reflect the Company's legal opinion regarding the strength or weakness of any particular patent or other legal position.

Estimated End-User DemandU.S. Pharmaceuticals

The following tables set forth for each of the Company's top 15 pharmaceutical products (based on 2005 annual net sales) and other products that the Company views as current and future growth drivers sold by the U.S. Pharmaceuticals business, for the years ended December 31, 2006, 2005 and 2004: (a) changes in reported U.S. net sales for the period; and (b) estimated total U.S. prescription growth for the retail and mail order channels calculated by the Company based on NPA data and Next-Generation Prescription Services (NGPS) version 1.0 data provided by IMS; and for the months ended December 31, 2006, 2005 and 2004, estimated U.S. therapeutic category share of the applicable product, calculated by the Company based on NPA data and NGPS data provided by IMS.

	Year Ended December 31, 2006			Month Ended December 31, 2006	
	% Change in U.S. Net Sales ^(a)	% Change in U.S. Total Prescriptions		Estimated TRx Therapeutic Category Share % ^(d)	
		NPA Data ^(b)	NGPS Data ^(c)	NPA Data ^(b)	NGPS Data ^(c)
Abilify (total revenue)	40	21	21	12	12
Avapro/Avalide	13	4	2	14	14
Baraclude ^(e)	**	**	**	25	24
Cefzil ⁽ⁱ⁾	(107)	(91)	(91)	—	—
Coumadin	2	(21)	(22)	16	15
Erbitux ^(f)	57	N/A	N/A	N/A	N/A
Glucophage Franchise	(45)	(49)	(49)	1	1
Kenalog ^(g)	29	N/A	N/A	N/A	N/A
Orencia ^(h)	—	N/A	N/A	N/A	N/A
Paraplatin ^(f)	(29)	N/A	N/A	N/A	N/A
Plavix	(18)	(18)	(20)	34	32
Pravachol	(57)	(59)	(59)	1	1
Reyataz ⁽ⁱ⁾	27	18	17	33	33
Sprycel ⁽ⁱ⁾	—	—	—	5	3
Sustiva Franchise ^{(i)(k)} (total revenue)	23	11	11	33	33
Tequin	(101)	(70)	(70)	—	—
Videx/Videx EC	(52)	(58)	(60)	1	1
Zerit	(23)	(30)	(30)	5	5

	Year Ended December 31, 2005			Month Ended December 31, 2005	
	% Change in U.S. Net Sales ^(a)	% Change in U.S. Total Prescriptions		Estimated TRx Therapeutic Category Share % ^(d)	
		NPA Data ^(b)	NGPS Data ^(c)	NPA Data ^(b)	NGPS Data ^(c)
Abilify (total revenue)	35	42	40	11	11
Avapro/Avalide	2	11	12	15	15
Baraclude ^(e)	—	—	—	12	11
Cefzil ⁽ⁱ⁾	(5)	(10)	(11)	2	2
Coumadin	(20)	(19)	(20)	21	20
Erbitux ^(f)	58	N/A	N/A	N/A	N/A
Glucophage Franchise	(52)	(63)	(62)	2	2
Kenalog ^(g)	14	N/A	N/A	N/A	N/A
Orencia ^(h)	—	N/A	N/A	N/A	N/A
Paraplatin ^(f)	(95)	N/A	N/A	N/A	N/A
Plavix	14	13	13	86	86
Pravachol	(10)	(17)	(16)	7	7
Reyataz ⁽ⁱ⁾	33	39	37	31	31
Sprycel ⁽ⁱ⁾	—	—	—	—	—
Sustiva ⁽ⁱ⁾	11	5	8	31	30
Tequin	(17)	(30)	(28)	1	1
Videx/Videx EC	(73)	(65)	(65)	2	2
Zerit	(18)	(31)	(30)	7	6

	Year Ended December 31, 2004			Month Ended December 31, 2004	
	% Change in U.S.		% Change in U.S. Total Prescriptions	Estimated TRx Therapeutic Category Share % ^(d)	
	Net Sales ^(a)	NPA Data ^(b)	NGPS Data ^(c)	NPA Data ^(b)	NGPS Data ^(c)
Abilify (total revenue)	98	103	103	9	9
Avapro/Avalide	19	15	18	15	15
<i>Baraclude</i> ^(e)	—	—	—	—	—
<i>Cefzil</i> ⁽ⁱ⁾	(31)	(30)	(29)	2	2
<i>Coumadin</i>	(18)	(17)	(21)	27	27
Erbitux ^(f)	—	N/A	N/A	N/A	N/A
Glucophage Franchise	(66)	(60)	(61)	3	3
<i>Kenalog</i> ^(g)	(3)	N/A	N/A	N/A	N/A
<i>Orencia</i> ^(h)	—	N/A	N/A	N/A	N/A
<i>Paraplatin</i> ^(f)	(30)	N/A	N/A	N/A	N/A
Plavix	36	24	27	85	85
<i>Pravachol</i>	(12)	(10)	(9)	9	9
<i>Reyataz</i> ⁽ⁱ⁾	**	**	**	26	27
<i>Sprycel</i> ^(j)	—	—	—	—	—
<i>Sustiva</i> ⁽ⁱ⁾	9	4	11	30	30
<i>Tequin</i>	(27)	(24)	(23)	2	2
<i>Videx/Videx EC</i>	(3)	(4)	3	9	9
<i>Zerit</i>	(32)	(29)	(27)	9	9

- (a) Reflects percentage change in net sales in dollar terms, including change in average selling prices and wholesaler buying patterns.
- (b) Based on a simple average of the estimated number of prescriptions in the retail and mail order channels as provided by IMS.
- (c) Based on a weighted-average of the estimated number of prescription units (tablets or milliliters) in the retail and mail order channels based on data provided by IMS.
- (d) The therapeutic categories are determined by the Company as those products considered to be in direct competition with the Company's own products. The products listed above compete in the following therapeutic categories: Abilify (antipsychotics), Avapro/Avalide (angiotensin receptor blockers), *Baraclude* (oral antiviral agents), *Cefzil* (branded oral solid and liquid antibiotics), *Coumadin* (warfarin), Erbitux (oncology), Glucophage Franchise (oral antidiabetics), *Kenalog* (intra-articular/intramuscular steroids), *Orencia* (fusion proteins), *Paraplatin* (carboplatin), Plavix (antiplatelet agents), *Pravachol* (HMG CoA reductase inhibitors), *Reyataz* (protease inhibitors excluding Norvir), *Sprycel* (TKIs for leukemia), the *Sustiva* Franchise (antiretrovirals - third agents excluding Norvir and Trizivir), *Tequin* (branded oral solid antibiotics), *Videx/Videx EC* and *Zerit* (nucleoside reverse transcriptase inhibitors).
- (e) *Baraclude* was launched in the U.S. in April 2005.
- (f) Erbitux and *Paraplatin* specifically, and parenterally administered oncology products in general, do not have prescription-level data because physicians do not write prescriptions for these products. The Company believes therapeutic category share information provided by third-parties for these products may not be reliable and accordingly, none is presented here.
- (g) The Company does not have prescription level data for *Kenalog* because the product is not dispensed through a retail pharmacy. The Company believes therapeutic category share information provided by third-parties for this product may not be reliable and accordingly none is presented here.
- (h) *Orencia* was launched in the U.S. in February 2006. The Company does not have prescription level data because the product is not dispensed through retail pharmacies.
- (i) Prior year Estimated TRx Therapeutic Category Share Percentage has been recalculated to conform with current year presentation for the following: *Cefzil* has been recalculated as a percentage share based on the combined Oral and Liquid/Suspension markets; *Reyataz* has been recalculated as a percentage share of the Protease Inhibitors excluding Norvir; the *Sustiva* Franchise has been recalculated as a percentage share of Antiretrovirals - Third Agents excluding Norvir and Trizivir.
- (j) *Sprycel* was launched in the U.S. in July 2006.
- (k) Beginning in the third quarter of 2006, the *Sustiva* Franchise (total revenue) includes sales of *Sustiva*, as well as revenue of bulk efavirenz included in the combination therapy, Atripla. The therapeutic category share information and change in U.S. total prescriptions growth for the *Sustiva* Franchise (Antiretrovirals - Third Agents excluding Norvir and Trizivir) includes both branded *Sustiva* and Atripla prescription units.

** Change is in excess of 200%.

The Company has historically reported estimated total U.S. prescription change and estimated therapeutic category share based on NPA data, which IMS makes available to the public on a subscription basis, and a simple average of the estimated number of prescriptions in the retail and mail order channels. In the third quarter of 2005, the Company began disclosing estimated total U.S. prescription change and estimated therapeutic category share based on both NPA and NGPS version 1.0 data. NGPS version 1.0 data was collected by IMS under a new, revised methodology and was released by IMS on a limited basis through a pilot program. IMS announced NGPS version 2.0 data is available to the public on a subscription basis starting in January 2007 and legacy NPA and NGPS version 1.0 will be discontinued. The Company believes that the NGPS data provided by IMS provides a superior estimate of prescription data for the Company's products in the retail and mail order channels. The Company has calculated the estimated total U.S. prescription change and estimated therapeutic category share based on NGPS data on a weighted-average basis to reflect the fact that mail order prescriptions include a greater volume of product supplied compared with retail prescriptions. The Company believes that calculation of the estimated total U.S. prescription change and estimated therapeutic category share based on the NGPS data and

the weighted-average approach with respect to the retail and mail order channels provides a superior estimate of total prescription demand. The Company now uses this methodology for its internal demand forecasts.

The estimated prescription change data and estimated therapeutic category share reported throughout this Annual Report only include information from the retail and mail order channels and do not reflect information from other channels, such as hospitals, institutions and long-term care, among others. The data provided by IMS are a product of IMS' own record-keeping processes and are themselves estimates based on sampling procedures, subject to the inherent limitations of estimates based on sampling. In addition, the NGPS version 1.0 data was part of a pilot program that was replaced by IMS and incorporated in the NGPS version 2.0 released in January 2007.

The Company continuously seeks to improve the quality of its estimates of prescription change amounts, therapeutic category share percentages and ultimate patient/consumer demand through review of its methodologies and processes for calculation of these estimates and review and analysis of its own and third-parties' data used in such calculations. The Company expects that it will continue to review and refine its methodologies and processes for calculation of these estimates and will continue to review and analyze its own and third-parties' data used in such calculations.

International Pharmaceuticals, Nutritionals and Other Health Care

The following table sets forth for each of the Company's key pharmaceutical products and other growth drivers sold by the Company's International Pharmaceuticals business, including the top 15 pharmaceutical products sold in the Company's major non-U.S. countries (based on 2005 net sales), and for each of the key products sold by the other reporting segments listed below, the percentage change in the Company's estimated ultimate patient/consumer demand for the months of December 2006 and September 2006 compared to the same period in the prior year. The Company commenced collecting the estimated ultimate patient/consumer demand for these reporting segments with the March 2005 period. The Company believes the year-to-year comparison below provides a more meaningful comparison to changes in sales for the quarter than the quarter-to-prior-quarter comparisons previously provided.

	% Change in Demand on a Constant U.S. Dollar Basis	
	December 2006 vs. December 2005	September 2006 vs. September 2005
International Pharmaceuticals		
Abilify (total revenue)	15	23
Avapro/Avalide	6	3
Baraclude	**	—
Bufferin	11	20
Capoten	(16)	(24)
Dafalgan	5	11
Efferalgan	2	(23)
Maxipime	(23)	(5)
Monopril	(10)	(15)
Paraplatin	(11)	(19)
Perfalgan	17	31
Plavix	(8)	(13)
Pravachol	(63)	(55)
Reyataz	23	20
Sustiva Franchise (total revenue)	4	2
TAXOL® (paclitaxel)	(18)	(26)
Videx/Videx EC	(33)	(22)
Nutritionals		
Enfamil/Enfagrow	6	5
Nutramigen	17	7
Other Health Care		
ConvaTec		
Ostomy	—	3
Wound Therapeutics	5	5
Medical Imaging		
Cardiolite	(5)	(5)

** Change is in excess of 200%.

Estimated Inventory Months on Hand in the Distribution ChannelU.S. Pharmaceuticals

The following tables set forth for each of the Company's top 15 pharmaceutical products (based on 2005 annual net sales) and other products that the Company views as current and future growth drivers sold by the Company's U.S. Pharmaceuticals business, the U.S. Pharmaceuticals net sales and the estimated number of months on hand of the applicable product in the U.S. wholesaler distribution channel for the quarters ended December 31 and September 30, 2006, 2005 and 2004. The Company believes the estimated number of months on hand for the quarters ended December 31 and September 30 for each of the three preceding years provide a more meaningful comparison to the Estimated End-User Demand for U.S. Pharmaceuticals disclosed above than the Company's former practice of providing the six most recent quarters.

Dollars in Millions	December 31, 2006		December 31, 2005		December 31, 2004	
	Net Sales	Months on Hand	Net Sales	Months on Hand	Net Sales	Months on Hand
Abilify (total revenue)	\$ 294	0.5	\$ 175	0.6	\$ 170	0.9
Avapro/Avalide	182	0.5	168	0.6	154	0.9
Baraclude	18	0.7	4	0.7	—	—
Cefzil	(5)	21.7	46	0.7	60	1.1
Coumadin	48	0.8	50	0.8	69	1.0
Erbitux	165	0.4	121	—	88	0.2
Glucophage Franchise	16	0.7	29	0.7	48	1.1
Kenalog	24	0.8	23	0.9	18	1.3
Orencia	31	0.4	—	—	—	—
Paraplatin	6	5.8	5	0.9	(12)	1.2
Plavix	343	0.6	906	0.6	816	0.9
Pravachol	50	0.6	366	0.6	433	1.0
Reyataz	144	0.7	110	0.5	99	0.9
Sprycel	11	1.4	—	—	—	—
Sustiva Franchise ^(a) (total revenue)	144	0.7	102	0.6	103	0.8
Tequin	(10)	—	22	0.9	39	0.9
Videx/Videx EC	2	1.1	7	0.9	25	0.9
Zerit	19	0.9	21	0.8	31	0.9

Dollars in Millions	September 30, 2006		September 30, 2005		September 30, 2004	
	Net Sales	Months on Hand	Net Sales	Months on Hand	Net Sales	Months on Hand
Abilify (total revenue)	\$ 260	0.5	\$ 214	0.9	\$ 152	0.6
Avapro/Avalide	159	0.4	147	0.5	148	0.6
Baraclude	14	0.6	2	1.2	—	—
Cefzil	1	29.2	27	0.7	30	0.6
Coumadin	45	0.7	49	0.6	58	0.9
Erbitux	173	0.5	106	—	83	0.2
Glucophage Franchise	20	0.7	38	0.7	39	1.0
Kenalog	19	0.8	19	0.7	9	1.7
Orencia	34	0.8	—	—	—	—
Paraplatin	5	1.5	9	1.1	145	1.2
Plavix	474	1.5	833	0.4	781	0.6
Pravachol	73	1.0	297	0.5	318	0.6
Reyataz	129	0.5	105	0.6	75	0.6
Sprycel	11	1.2	—	—	—	—
Sustiva Franchise ^(a) (total revenue)	128	0.5	101	0.6	95	0.7
Tequin	2	2.3	21	0.9	31	0.7
Videx/Videx EC	3	0.9	7	1.1	27	0.6
Zerit	19	0.7	24	0.8	34	0.7

(a) Beginning in the third quarter of 2006, the *Sustiva* Franchise includes sales of *Sustiva*, as well as revenue of bulk efavirenz included in the combination therapy, Atripla. The estimated months on hand of the product in the U.S. wholesale distribution channel only include branded *Sustiva* inventory.

Baraclude was launched in the U.S. in April 2005. In anticipation of the launch, the Company's U.S. wholesalers built inventories of the product to meet expected demand and at September 30, 2005, *Baraclude* inventory in the U.S. wholesaler distribution channel exceeded one month on hand. The estimated value of *Baraclude* inventory in the U.S. wholesaler distribution channel had been worked down to less than one month on hand in subsequent quarters.

At December 31, 2006 and September 30, 2006, the estimated value of *Cefzil* inventory in the U.S. wholesaler distribution channel exceeded one month on hand by approximately \$9.7 million and \$11.8 million, respectively. The demand for *Cefzil* decreased significantly in 2006 due to reduced wholesaler out-movements as generic competition began in the U.S. in December 2005. At December 31, 2004, the estimated value of *Cefzil* inventory exceeded one month on hand by approximately \$1.6 million as the Company built higher inventories of the product to meet expected higher demand typically experienced in the winter months in the U.S. The Company continues to monitor *Cefzil* sales with the objective to work down wholesaler inventory levels to one month on hand or less.

At December 31, 2004, the estimated value of Glucophage Franchise products inventory (Glucophage XR, Glucophage IR, Glucovance and Metaglip) in the U.S. wholesaler distribution channel exceeded one month on hand by approximately \$1.6 million. As with all products, the months on hand estimate for the Glucophage Franchise products is an average of months on hand for all stock-keeping units (SKUs) of the product group. The increase in months on hand of the Glucophage Franchise products at the end of the fourth quarter 2004 to more than one month on hand resulted primarily from the purchase by wholesalers of certain SKUs. After giving effect to these purchases, the increased months on hand for these SKUs were less than one month on hand. However, when the increased months on hand for these SKUs were averaged with all SKUs for the Glucophage Franchise products, the aggregate estimated months on hand exceeded one month. At March 31, 2005, the estimated value of Glucophage Franchise products inventory in the U.S. wholesaler distribution channel had been worked down to approximately one month on hand, and has been worked down to, and remained at, less than one month on hand in subsequent quarters.

At December 31, 2004 and September 30, 2004, the estimated value of *Kenalog* inventory in the U.S. wholesaler distribution channel exceeded one month on hand by approximately \$1.0 million and \$2.6 million, respectively, due to high levels of goods-in-transit caused by shipping delays. In subsequent quarters, the estimated value of *Kenalog* inventory in the U.S. wholesaler distribution channel had been worked down to less than one month on hand.

In October 2004, the U.S. pediatric exclusivity period for *Paraplatin* expired. The resulting entry of multiple generic competitors for *Paraplatin* led to a significant decrease in demand for *Paraplatin*, which in turn led to the months on hand of the product in the U.S. wholesaler distribution channel exceeding one month on hand at December 31, 2006, September 30, 2006, September 30, 2005, December 31, 2004 and September 30, 2004. The estimated value of *Paraplatin* inventory in the U.S. wholesaler distribution channel over one month on hand was approximately \$0.6 million at December 31, 2006, \$0.6 million at September 30, 2006, \$0.7 million at September 30, 2005, \$6.0 million at December 31, 2004 and \$6.6 million at September 30, 2004. The Company no longer produces *Paraplatin* for the U.S. market and will continue to monitor *Paraplatin* wholesaler inventory levels until they have been depleted.

At September 30, 2006, the estimated value of Plavix inventory in the U.S. wholesaler distribution channel exceeded one month on hand by approximately \$41.4 million due to the at-risk launch of generic clopidogrel bisulfate in August 2006. Demand for Plavix decreased precipitously following the at-risk launch of generic clopidogrel bisulfate. As of December 31, 2006, Plavix inventory in the U.S. wholesaler distribution channel has been worked down to less than one month on hand.

Sprycel was launched in the U.S. in July 2006. Consistent with customary practice at the time of a new product launch, the Company's U.S. wholesalers built inventories of the product to meet expected demand, and at December 31, 2006 and September 30, 2006, the estimated value of *Sprycel* inventory in the U.S. wholesaler distribution channel exceeded one month on hand by approximately \$1.4 million and \$0.6 million, respectively. The Company continues to monitor *Sprycel* inventory and sales with the objective to work down wholesaler inventory levels to one month on hand or less.

In the first quarter of 2006, the Company made the decision to discontinue commercialization of *Tequin* for commercial reasons. The Company stopped shipping product to U.S. wholesalers in June 2006 and established an accrual for the estimated returns of *Tequin* inventory. In July 2006, the Company notified the U.S. wholesaler and retail distribution channels that it would allow for return of the product regardless of expiry dates. The estimated value of *Tequin* inventory in the U.S. wholesaler distribution channel that exceeded one month on hand was de minimis at September 30, 2006. As of December 31, 2006, the Company is not aware of any significant amounts of *Tequin* inventory remaining in the U.S. wholesaler distribution channel. The Company expects most of the *Tequin* inventory in all U.S. channels to be reduced to nominal levels in the first quarter of 2007.

The estimated value of *Videx/Videx EC* (didanosine) inventory in the U.S. wholesaler distribution channel that exceeded one month on hand was de minimis at December 31, 2006 and was approximately \$0.2 million at September 30, 2005. As a result of generic competition in the U.S. commencing in the fourth quarter of 2004, demand for *Videx/Videx EC* decreased significantly.

For all products other than Erbitux and *Orencia*, the Company determines the above months on hand estimates by dividing the estimated amount of the product in the U.S. wholesaler distribution channel by the estimated amount of out-movement of the product from the U.S. wholesaler distribution channel over a period of 31 days, all calculated as described below. Factors that may influence

the Company's estimates include generic competition, seasonality of products, wholesaler purchases in light of increases in wholesaler list prices, new product launches, new warehouse openings by wholesalers and new customer stockings by wholesalers. In addition, such estimates are calculated using third-party data, which represent their own record-keeping processes and as such, may also reflect estimates.

The Company maintains inventory management agreements (IMAs) with most of its U.S. Pharmaceuticals wholesalers, which account for nearly 100% of total gross sales of U.S. pharmaceutical products. Under the current terms of the IMAs, the Company's three largest wholesaler customers provide the Company with weekly information with respect to inventory levels of product on hand and the amount of out-movement of products. These three wholesalers accounted for approximately 90% of total gross sales of U.S. pharmaceutical products in 2006. The inventory information received from these wholesalers excludes inventory held by intermediaries to whom they sell, such as retailers and hospitals, and excludes goods in transit to such wholesalers. The Company uses the information provided by these three wholesalers as of the Friday closest to quarter end to calculate the amount of inventory on hand for these wholesalers at the applicable quarter end. This amount is then increased by the Company's estimate of goods in transit to these wholesalers as of the applicable Friday, which have not been reflected in the weekly data provided by the wholesalers. Under the Company's revenue recognition policy, sales are recorded when substantially all the risks and rewards of ownership are transferred, which in the U.S. Pharmaceuticals business is generally when product is shipped. In such cases, goods in transit to a wholesaler are owned by the applicable wholesaler and, accordingly, are reflected in the calculation of inventories in the wholesaler distribution channel. The Company estimates the amount of goods in transit by using information provided by these wholesalers with respect to their open orders as of the applicable Friday and the Company's records of sales to these wholesalers with respect to such open orders. The Company determines the out-movement of a product from these wholesalers over a period of 31 days by using the most recent four weeks of out-movement of a product as provided by these wholesalers and extrapolating such amount to a 31 day basis. The Company estimates inventory levels on hand and out-movements for its U.S. Pharmaceuticals business wholesaler customers other than the three largest wholesalers for each product based on the assumption that such amounts bear the same relationship to the three largest wholesalers' inventory levels and out-movements for such product as the percentage of aggregate sales for all products to these other wholesalers in the applicable quarter bears to aggregate sales for all products to the Company's three largest wholesalers in such quarter. Finally, the Company considers whether any adjustments are necessary to these extrapolated amounts based on such factors as historical sales of individual products made to such other wholesalers and third-party market research data related to prescription trends and patient demand. In addition, the Company receives inventory information from these other wholesalers on a selective basis for certain key products.

The Company's U.S. Pharmaceuticals business through the IMAs discussed above has arrangements with substantially all of its direct wholesaler customers and requires those wholesalers to maintain inventory at levels that are no more than one month of their demand.

In response to the at-risk launch of generic clopidogrel bisulfate on August 8, 2006, the Company offered certain U.S. MCOs incremental rebates from its wholesaler list price for Plavix under certain conditions through March 31, 2007. A small number of MCOs accepted the offer. All other offers were rejected, did not qualify or were terminated prior to or at the time of the issuance of the preliminary injunction on August 31, 2006, and no further such offers have been made. The Company also provided a temporary price reduction below the Federal supply schedule for Plavix to the Veterans Administration for a limited period in August and September 2006. Primarily as a result of very limited participation in the rebate offer, the Company estimates that the impact of the two programs on Plavix net sales in the third and fourth quarters was de minimis.

Orencia was launched in February 2006. From launch through the second quarter, the Company distributed *Orencia* through an exclusive distribution arrangement with a single distributor. Following approval of the supplemental Biologics License Application (sBLA) that allows a third-party to manufacture *Orencia* at an additional site, the exclusive distribution arrangement terminated on July 17, 2006 and the Company expanded its distribution network for *Orencia* to multiple distributors. The above estimates of months on hand were calculated by dividing the inventories of *Orencia* held by these distributors at the end of the quarter by the out-movement of the product over the last 31 day period, as reported by these distributors. The inventory on hand and out-movements reported by these distributors are a product of the distributors' own record-keeping processes.

During 2004 and through May 2005, McKesson Corporation (McKesson), one of the Company's wholesalers, provided warehousing, packing and shipping services for Erbitux. McKesson held Erbitux inventory on consignment and, under the Company's revenue recognition policy, the Company recognized revenue when such inventory was shipped by McKesson to the end-users. McKesson also held inventories of Erbitux for its own account. Upon the divestiture of OTN in May 2005, the Company discontinued the consignment arrangement with McKesson and McKesson no longer held inventories for its own account. Thereafter, the Company sold Erbitux to intermediaries (such as wholesalers and specialty oncology distributors) and shipped Erbitux directly to the end-users of the product who are the customers of those intermediaries. Beginning in the third quarter of 2006, the Company expanded its distribution model to include one of the Company's wholesalers who then held Erbitux inventory. The Company recognizes revenue upon such shipment consistent with its revenue recognition policy.

The above estimate of months on hand was calculated by dividing the inventories of Erbitux held by the wholesaler for its own account as reported by the wholesaler as of the end of the quarter by the out-movements of the product reported by that wholesaler over the last 31 day period. The inventory levels reported by the wholesaler are a product of the wholesaler's own record-keeping process.

As previously disclosed, for the Company's Pharmaceuticals business outside of the U.S., Nutritionals and Other Health Care business units around the world, the Company has significantly more direct customers, limited information on direct customer product level inventory and corresponding out-movement information and the reliability of third-party demand information, where available, varies widely. Accordingly, the Company relies on a variety of methods to estimate direct customer product level inventory and to calculate months on hand for these business units.

Estimated Inventory Months on Hand in the Distribution Channel

The following table sets forth for each of the Company's key products sold by the businesses listed below, the net sales of the applicable product for each of the quarters ended December 31, 2006, September 30, 2006, December 31, 2005 and September 30, 2005, and the estimated number of months on hand of the applicable product in the direct customer distribution channel for the businesses as of the end of each of the four quarters. The Company believes the estimated number of months on hand for the quarters ended December 31 and September 30 for each of the two preceding years provide a more meaningful comparison to the Estimated End-User Demand for International Pharmaceuticals, Nutritionals and Other Health Care disclosed above than the Company's former practice of providing the four most recent quarters. The estimates of months on hand for key products described below for the International Pharmaceuticals business are based on data collected for all of the Company's significant business units outside of the U.S. Also described further below is information on non-key product(s) where the amount of inventory on hand at direct customers is more than approximately one month and the impact is not de minimis. For the other non-Pharmaceuticals reporting segments, estimates are based on data collected for the U.S. and all significant business units outside of the U.S.

Dollars in Millions	December 31, 2006		September 30, 2006	
	Net Sales	Months On Hand	Net Sales	Months on Hand
International Pharmaceuticals				
Abilify (total revenue)	\$ 68	0.7	\$ 53	0.6
Avapro/Avalide	125	0.6	118	0.5
Baraclude	18	0.8	8	0.9
Bufferin	32	0.5	28	0.5
Capoten	31	0.8	28	0.8
Dafalgan	40	1.0	35	1.1
Efferalgan	74	0.7	62	0.9
Maxipime	33	0.6	40	0.7
Monopril	35	0.9	34	1.0
Paraplatin	28	0.8	27	0.6
Perfalgan	54	0.5	48	0.6
Plavix	153	0.6	156	0.6
Pravachol	96	0.8	119	0.7
Reyataz	111	1.0	104	1.1
Sustiva Franchise ^(a) (total revenue)	78	0.5	73	0.5
TAXOL [®] (paclitaxel)	128	0.7	135	0.6
Videx/Videx EC	29	1.4	35	1.4
Nutritionals				
Enfamil/Enfagrow	338	0.9	315	0.8
Nutramigen	54	1.0	50	1.0
Other Health Care				
ConvaTec				
Ostomy	151	1.0	139	0.9
Wound Therapeutics	123	1.0	113	0.9
Medical Imaging				
Cardiolite	103	0.9	97	0.8

- (a) Beginning in the third quarter of 2006, the Sustiva Franchise includes sales of Sustiva, as well as revenue of bulk efavirenz included in the combination therapy, Atripla. The estimated months on hand of the product in the distribution channel only include branded Sustiva inventory.

Dollars in Millions	December 31, 2005		September 30, 2005	
	Net Sales	Months on Hand	Net Sales	Months on Hand
International Pharmaceuticals				
Abilify (total revenue)	\$ 49	0.6	\$ 46	0.8
Avapro/Avalide	109	0.6	104	0.5
<i>Baraclude</i>	1	—	—	—
Bufferin	36	0.7	31	0.6
<i>Capoten</i>	38	0.8	38	0.9
<i>Dafalgan</i>	34	1.2	34	1.3
<i>Efferalgan</i>	74	1.0	66	1.1
<i>Maxipime</i>	48	0.8	40	0.7
<i>Monopril</i>	43	0.9	48	1.0
<i>Paraplatin</i>	33	0.8	33	0.6
<i>Perfalgan</i>	43	0.6	38	0.7
Plavix	155	0.6	147	0.6
<i>Pravachol</i>	218	0.8	230	0.8
<i>Reyataz</i>	78	0.6	71	0.9
<i>Sustiva</i> Franchise ^(a) (total revenue)	68	0.6	69	0.6
<i>TAXOL</i> [®] (paclitaxel)	176	0.8	171	0.5
<i>Videx/Videx EC</i>	34	0.9	34	0.9
Nutritionals				
<i>Enfamil/Enfagrow</i>	330	1.0	284	0.9
<i>Nutramigen</i>	48	1.1	44	1.1
Other Health Care				
ConvaTec				
Ostomy	145	1.0	139	0.9
Wound Therapeutics	112	0.9	104	0.8
Medical Imaging				
<i>Cardiolite</i>	100	1.0	106	0.8

The above months on hand information represents the Company's estimates of aggregate product level inventory on hand at direct customers divided by the expected demand for the applicable product. Expected demand is the estimated ultimate patient/consumer demand calculated based on estimated end-user consumption or direct customer out-movement data over the most recent 31 day period or other reasonable period. Factors that may affect the Company's estimates include generic competition, seasonality of products, direct customer purchases in light of price increases, new product or product presentation launches, new warehouse openings by direct customers, new customer stockings by direct customers and expected direct customer purchases for governmental bidding situations.

The Company relies on a variety of methods to calculate months on hand for these businesses and reporting segments. Where available, the Company relies on information provided by third-parties to determine estimates of aggregate product level inventory on hand at direct customers and expected demand. For the businesses and reporting segments listed above; however, the Company has limited information on direct customer product level inventory, end-user consumption and direct customer out-movement data. Further, the quality of third-party information, where available, varies widely. In some circumstances, such as the case with new products or seasonal products, such historical end-user consumption or out-movement information may not be available or applicable. In such cases, the Company uses estimated prospective demand. In cases where direct customer product level inventory, ultimate patient/consumer demand or out-movement data do not exist or are otherwise not available, the Company has developed a variety of other methodologies to calculate estimates of such data, including using such factors as historical sales made to direct customers and third-party market research data related to prescription trends and end-user demand.

As of September 30, 2006, the Company has entered into exclusive distributorship arrangements for certain products in several Eastern and Central European markets.

As of September 30, 2006, December 31, 2005 and September 30, 2005, *Dafalgan*, an analgesic product sold principally in Europe, had approximately 1.1, 1.2 and 1.3 months of inventory on hand, respectively, at direct customers. The level of inventory on hand was due primarily to private pharmacists purchasing *Dafalgan* approximately once every eight weeks and the seasonality of the product.

As of September 30, 2005, *Efferalgan*, an analgesic product sold principally in Europe, had approximately 1.1 months of inventory on hand at direct customers. The level of inventory on hand was due primarily to private pharmacists purchasing *Efferalgan* approximately once every eight weeks and the seasonality of the product.

As of September 30, 2006, *Reyataz*, an antiviral product, had approximately 1.1 months of inventory on hand at direct customers. The increased level of inventory on hand was due primarily to government purchasing patterns in Brazil.

As of December 31, 2006 and September 30, 2006, *Videx/Videx EC*, an antiviral product, had approximately 1.4 months of inventory on hand at direct customers. The increased level of inventory on hand was due primarily to government purchasing patterns in Brazil. The Company is contractually obligated to provide *Videx/Videx EC* to the Brazilian government upon placement of an order for product by the government. Under the terms of the contract, the Company has no control over the inventory levels relating to such orders. The Company, however, expects that the inventory levels for *Videx/Videx EC* will be worked down.

As of December 31, 2005 and September 30, 2005, *Nutramigen*, an infant nutritional product sold principally in the U.S., had approximately 1.1 months of inventory on hand at direct customers. The level of inventory on hand at the end of the quarter ended December 31, 2005 was due primarily to holiday stocking by retailers and at the quarter ended September 30, 2005 was due primarily to the impact of retailers holding higher levels of inventory in response to Hurricane Katrina.

The Company continuously seeks to improve the quality of its estimates of months on hand of inventories held by its direct customers including thorough review of its methodologies and processes for calculation of these estimates and a thorough review and analysis of its own and third-parties' data used in such calculations. The Company expects that it will continue to review and refine its methodologies and processes for calculation of these estimates and will continue to review and analyze its own and third-parties' data in such calculations. The Company also has and will continue to take steps to expedite the receipt and processing of data for the non-U.S. Pharmaceuticals businesses.

Health Care Group

The combined 2006 revenues from the Health Care Group increased 3% to \$4,053 million compared to the same period in 2005, despite a 4% unfavorable impact from the divestiture of the U.S. and Canadian Consumer Medicines (Consumer Medicines) business in the third quarter of 2005. The combined 2005 revenues from the Health Care Group increased 4% to \$3,953 million compared to the same period in 2004.

Nutritionals

The changes in Nutritionals sales were as follows:

	Total Change	Analysis of % Change		
		Volume	Price	Foreign Exchange
2006 vs. 2005	6%	2%	3%	1%
2005 vs. 2004	10%	7%	2%	1%

Key Nutritionals product lines and their sales, representing 96%, 95% and 94% of total Nutritional sales in 2006, 2005 and 2004, respectively, were as follows:

Dollars in Millions	2006	2005	2004	% Change	
				2006 vs. 2005	2005 vs. 2004
Infant Formulas	\$1,637	\$ 1,576	\$ 1,405	4%	12%
<i>Enfamil</i>	1,007	992	859	2%	15%
Toddler/Children's Nutritionals	606	529	468	15%	13%
<i>Enfagrow</i>	262	206	179	27%	15%

Worldwide Nutritionals sales increased 6%, including a 1% favorable foreign exchange impact, to \$2,347 million in 2006 from 2005. In 2005, Worldwide Nutritionals sales were \$2,205 million, an increase of 10%, including a 1% favorable foreign exchange impact and despite a 2% unfavorable impact from the divestiture of the Adult Nutritional business, from \$2,001 million in 2004. In the first quarter of 2004, the Company divested its Adult Nutritional business.

International sales increased 11%, including a 3% favorable foreign exchange impact, to \$1,256 million in 2006 from 2005, primarily due to increased sales of children's nutritional products. In 2005, international sales increased 12%, including a 2% favorable foreign exchange impact and despite a 1% unfavorable impact from the divestiture of the Adult Nutritional business, to \$1,135 million from \$1,010 million in 2004, primarily due to the increased sales of *Enfamil* and *Enfagrow*.

U.S. sales increased 2% to \$1,091 million in 2006 from 2005, primarily due to increased sales of *Enfamil*. In 2005, U.S. sales increased 8%, despite a 3% unfavorable impact from the divestiture of the Adult Nutritional business, to \$1,070 million from \$991 million in 2004, primarily due to increased sales of *Enfamil*.

Other Health Care

The Other Health Care segment includes ConvaTec and the Medical Imaging business, as well as the Consumer Medicines business in 2005 and 2004. In the third quarter of 2005, the Company sold its Consumer Medicines business and related assets. The composition of the changes in Other Health Care segment sales were as follows:

	Total Change	Analysis of % Change		
		Volume	Price	Foreign Exchange
2006 vs. 2005	(2)%	(2)%	(1)%	1%
2005 vs. 2004	(4)%	(4)%	(1)%	1%

Other Health Care sales decreased 2% to \$1,706 million compared to the same period in 2005, which included a 9% unfavorable impact for the divestiture of the Consumer Medicines business. Other Health Care sales in 2005 decreased 4% to \$1,748 million compared to the same period in 2004, which included a 7% unfavorable impact for the divestiture of the Consumer Medicines business.

Other Health Care sales by business and their key products for the years ended December 31, were as follows:

Dollars in Millions	2006	2005	% Change		
			2004	2006 vs. 2005	2005 vs. 2004
ConvaTec	\$1,048	\$ 992	\$ 954	6%	4%
Ostomy	554	550	551	1%	—
Wound Therapeutics	441	416	391	6%	6%
Medical Imaging	658	602	589	9%	2%
<i>Cardiolite</i>	408	416	406	(2)%	2%
Consumer Medicines	—	154	272	(100)%	(43)%

- Worldwide ConvaTec sales increased 6%, including a 1% favorable foreign exchange impact, to \$1,048 million in 2006 from 2005. Ostomy sales increased 1% to \$554 million in 2006, including a 1% favorable foreign exchange impact. Sales of wound therapeutic products increased 6%, including a 1% favorable foreign exchange impact, to \$441 million in 2006 from \$416 million in 2005, primarily due to continued growth of the *Aquacel* franchise. In 2005, worldwide ConvaTec sales increased 4%, including a 1% favorable foreign exchange impact, to \$992 million from \$954 million in 2004, primarily due to an increase in worldwide sales of wound therapeutic products.
- Worldwide Medical Imaging sales increased 9% to \$658 million in 2006 from 2005. This growth was primarily due to an increase in TechnoLite technetium Tc99m generator sales resulting from a competitor's market absence in the first quarter of 2006 and an increase in *Definity* sales during a competitor's continued absence from the market. *Cardiolite* sales decreased 2% to \$408 million in 2006 from \$416 million in 2005, primarily due to decreased price. In 2005, Medical Imaging sales increased 2% to \$602 million from \$589 million in 2004, primarily due to increased demand for *Cardiolite*.

Geographic Areas

In general, the Company's products are available in most countries in the world. The largest markets are in the U.S., France, Japan, Canada, Spain, Italy, Mexico and Germany. The Company's sales by geographic areas were as follows:

Dollars in Millions	2006	2005	2004	% Change	
				2006 vs. 2005	2005 vs. 2004
United States	\$ 9,729	\$ 10,461	\$ 10,613	(7)%	(1)%
% of Total	55%	54%	55%		
Europe, Middle East and Africa	4,544	5,136	5,470	(12)%	(6)%
% of Total	25%	27%	28%		
Other Western Hemisphere	1,615	1,592	1,425	1%	12%
% of Total	9%	8%	7%		
Pacific	2,026	2,018	1,872	—	8%
% of Total	11%	11%	10%		
Total	\$ 17,914	\$ 19,207	\$ 19,380	(7)%	(1)%

Sales in the U.S. decreased 7% in 2006, primarily as a result of lower sales of Plavix and the loss of exclusivity of *Pravachol* in April 2006. This decrease in sales was partially offset by growth of the remaining pharmaceutical growth drivers and recently launched products. In 2005, sales in the U.S. decreased 1% in 2005, as a result of lower sales of *Paraplatin* and the Glucophage Franchise due to the continuing impact of earlier exclusivity losses, and *Pravachol*, due to lower demand resulting from increased competition. This decrease in sales was mostly offset by increased sales of growth drivers including Plavix, Abilify, Erbitux and *Reyataz*, as well as strong sales growth of *Enfamil*.

Sales in Europe, Middle East and Africa decreased 12% as a result of sales decline of *Pravachol* and *TAXOL*[®] (paclitaxel) resulting from increased generic competition. This decrease in sales was partially offset by increased sales in major European markets of *Reyataz* and Avapro/Avalide. In 2005, sales decreased 6%, including a 1% favorable foreign exchange impact, as a result of a sales decline of *TAXOL*[®] (paclitaxel), due to increased generic competition, and *Pravachol*, due to exclusivity loss in select markets, including the UK and the Netherlands. This decrease in sales was partially offset by increased sales in major European markets of *Reyataz* and Abilify, which were both launched in Europe in the second quarter of 2004.

Sales in the Other Western Hemisphere countries increased 1%, including a 3% favorable foreign exchange impact, primarily due to increased sales of Avapro/Avalide in Canada and key nutritional products, partially offset by decreased sales of *Tequin* and other pharmaceutical products. In 2005, sales increased 12%, including a 7% favorable foreign exchange impact, primarily due to increased sales of Plavix in Canada and Mexico, *Reyataz* in Brazil and Canada, and Avapro/Avalide in Canada.

Sales in the Pacific region remained consistent compared to 2005. In 2005, sales increased 8%, as a result of increased sales of *TAXOL*[®] (paclitaxel) in Japan, and *Enfagrow* and *Enfamil* in China.

Expenses

Dollars in Millions	2006	2005	2004	% Change	
				2006 vs. 2005	2005 vs. 2004
Cost of products sold	\$ 5,956	\$ 5,928	\$ 5,989	—	(1)%
% of net sales	33.2%	30.9%	30.9%		
Marketing, selling and administrative	\$ 4,919	\$ 5,106	\$ 5,016	(4)%	2%
% of net sales	27.5%	26.6%	25.9%		
Advertising and product promotion	\$ 1,351	\$ 1,476	\$ 1,411	(8)%	5%
% of net sales	7.5%	7.7%	7.3%		
Research and development	\$ 3,067	\$ 2,746	\$ 2,500	12%	10%
% of net sales	17.1%	14.3%	12.9%		
Acquired in-process research and development	\$ —	\$ —	\$ 63	—	(100)%
% of net sales	—	—	0.3%		
Provision for restructuring, net	\$ 59	\$ 32	\$ 104	84%	(69)%
% of net sales	0.3%	0.1%	0.5%		
Litigation charges, net	\$ 302	\$ 269	\$ 420	12%	(36)%
% of net sales	1.7%	1.4%	2.2%		
Gain on sale of businesses	\$ (200)	\$ (569)	\$ (320)	65%	(78)%
% of net sales	(1.1)%	(3.0)%	(1.7)%		
Equity in net income of affiliates	\$ (474)	\$ (334)	\$ (273)	(42)%	(22)%
% of net sales	(2.6)%	(1.7)%	(1.4)%		
Other expense, net	\$ 299	\$ 37	\$ 52	**	(29)%
% of net sales	1.7%	0.2%	0.3%		
Total Expenses, net	\$ 15,279	\$ 14,691	\$ 14,962	4%	(2)%
% of net sales	85.3%	76.5%	77.2%		

** Change is in excess of 200%.

- Cost of products sold, as a percentage of sales, increased to 33.2% in 2006 compared with 30.9% in 2005. In 2006, the Company included \$91 million, or 0.5% as a percentage of sales, of certain costs in cost of products sold, which were reported in marketing, selling and administrative expenses in the prior year results. In addition to the reclassification, the increase was primarily due to the unfavorable impact of pharmaceutical net sales mix, including lower sales of Plavix and impairment charges for *Tequin* and EMSAM related assets, as well as for a manufacturing facility. In 2005 and 2004, cost of products sold, as a percentage of sales, was 30.9%. In 2005, the unfavorable impact on gross margins resulting from the change in the U.S. Pharmaceuticals sales mix was offset by *Tequin* impairment charges and \$76 million of net litigation charges recorded in 2004.
- Marketing, selling and administrative expenses decreased 4% to \$4,919 million as compared to 2005, including a 2% decrease resulting from the above-mentioned reclassification. In addition to the reclassification, the decrease was primarily due to lower sales force expenses resulting from the previously announced restructuring of the U.S. primary care sales organization that became effective in March 2006 and lower expenses for *Pravachol*, partially offset by the impact of the adoption of stock option expensing. In 2005, marketing, selling and administrative expenses increased 2% to \$5,106 million from \$5,016 million in 2004, primarily due to higher legal costs and higher pension expenses, reflecting increased amortization of unrecognized net losses as well as change in actuarial assumptions, partially offset by lower sales force expenses resulting from a focus on specialists and high value primary care physicians. Marketing, selling and administrative expenses as a percentage of sales were 27.5%, which included a 0.5% decrease from the reclassification; compared with 26.6% and 25.9% in 2005 and 2004, respectively.
- Advertising and product promotion expenditures decreased 8% to \$1,351 million as compared to 2005, primarily driven by the divestiture of the Consumer Medicines business in 2005 and lower spending on mature brands, partially offset by increased investments in new products including *Orencia* and *Sprycel*. In 2005, advertising and product promotion expenditures increased 5% to \$1,476 million as compared to \$1,411 million in 2004, primarily due to increased investments in direct-to-consumer marketing campaigns for Plavix and Abilify, increased costs associated with pre-launch activities for *Orencia* and the launch of *Baraclude*, partially offset by lower spending on mature products.
- The Company's investment in research and development was \$3,067 million in 2006, an increase of 12% over 2005. In 2005, the investment in research and development was \$2,746 million, which represented a 10% increase over \$2,500 million in 2004. The increases in both 2006 and 2005 reflect the Company's strategy with continued investments in late-stage compounds and developing a pipeline in disease areas that address significant unmet medical needs. Research and development costs also included charges consisting primarily of upfront and milestone payments of \$85 million in 2006, primarily to Exelixis Pharmaceuticals, Inc. and Solvay Global (Solvay), \$72 million in 2005, primarily to Medarex and Pierre Fabre Medicament S.A. (Pierre Fabre) and \$58 million in 2004, primarily to Pierre Fabre and Solvay. As a percentage of sales, research and development expenses were 17.1% in 2006 compared with 14.3% in 2005 and 12.9% in 2004. The percentage of sales in 2006 was impacted by lower Plavix sales.
- Acquired in-process research and development of \$63 million in 2004 was related to the purchase of Acordis, a UK-based company. For additional information on the acquisition, see Note 4 "Acquisitions and Divestitures."
- Restructuring programs have been implemented to realign and streamline operations in order to increase productivity, reduce operating expenses and to rationalize the Company's manufacturing network, research facilities, and the sales and marketing organizations. Actions under the 2006 restructuring program are expected to be substantially complete during 2008 while actions under the 2005 and 2004 restructuring programs were substantially completed at December 31, 2006. As a result of these actions, the Company expects the future annual benefit to earnings from continuing operations before minority interest and income taxes to be approximately \$64 million, \$77 million and \$186 million for the 2006, 2005 and 2004 programs, respectively. For additional information on restructuring, see Note 3 "Restructuring."
- Litigation charges, net of settlement income and insurance recoveries, were \$302 million in 2006, \$269 million in 2005 and \$420 million in 2004. The \$302 million net charge in 2006 consisted of an increase to the reserves of \$353 million for the settlement in principle of certain pricing and sales investigations, partially offset by insurance recoveries of \$37 million from an unrelated matter and \$14 million in income from a settlement of a litigation matter. The \$269 million net charge in 2005 consisted of increases to the reserves of \$590 million for liabilities, primarily related to private litigations and governmental investigations, partially offset by insurance recoveries of \$321 million. The \$420 million charge in 2004 consisted of \$336 million related to private litigation and governmental investigations related to wholesaler inventory issues and accounting matters, \$50 million related to the *Platinol* litigation settlement and \$34 million related to pharmaceutical pricing and sales practices. For additional information on litigation, see Note 21 "Legal Proceedings and Contingencies."

- The gain on sale of businesses of \$200 million (\$130 million net of tax) in 2006 was related to the sale of inventory, trademark, patent and intellectual property rights related to Dovonex. The gain on sale of businesses of \$569 million (\$370 million net of tax) in 2005 was related to the sale of the Consumer Medicines business and related assets. The gain on sale of business of \$320 million (\$198 million net of tax) in 2004 was related to the sale of the Adult Nutritional business. For additional information on these transactions, see Note 4 “Acquisitions and Divestitures.”
- Equity in net income of affiliates for 2006 was \$474 million, compared with \$334 million and \$273 million in 2005 and 2004, respectively. Equity in net income of affiliates is principally related to the Company’s joint venture with Sanofi and investment in ImClone. In 2006, the \$140 million increase in equity in net income of affiliates was primarily due to increased net income in the joint venture with Sanofi and income from the equity investment in ImClone in 2006 compared to a loss in 2005. In 2005, the \$61 million increase in equity in net income of affiliates from 2004 primarily reflects an increase in net income in the Sanofi joint venture, partially offset by a net loss from the investment in ImClone. For additional information on equity in net income of affiliates, see Note 2 “Alliances and Investments.”
- Other expense, net, was \$299 million, \$37 million and \$52 million in 2006, 2005 and 2004, respectively. Other expense, net includes net interest expense, foreign exchange gains and losses, income from third-party contract manufacturing, royalty income and expense, debt retirement costs, gains and losses on disposal of property, plant and equipment, gains and losses on sale of marketable securities and certain other litigation matters. The \$262 million increase in other expense, net, in 2006 from 2005 was primarily due to higher debt retirement costs in connection with the repurchase in 2006 of the \$2.5 billion Notes due 2011 compared to the repurchase in 2005 of the \$2.5 billion Notes due 2006, as well as a \$143 million non-recurring income in 2005 resulting from the termination of the muraglitazar collaborative agreement, partially offset by lower net foreign exchange losses. The \$15 million decrease in other expense, net in 2005 from 2004 was primarily due to deferred income recognized from the termination of the collaborative agreement for muraglitazar, partially offset by debt retirement costs in connection with the repurchase of the \$2.5 billion Notes due 2006 and higher net foreign exchange losses. For additional information, see Note 7 “Other Expense, Net.”

Stock-based compensation expense recognized under SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)) for the year ended December 31, 2006, was \$112 million. These charges were recorded in cost of product sold, marketing selling and administrative expenses, and research and development expenses. Stock-based compensation expense recognized under Accounting Principles Board (APB) No. 25 for the years ended December 31, 2005 and 2004 was \$31 million and \$30 million, respectively. These expenses were recorded in marketing, selling and administrative expenses.

During the years ended December 31, 2006, 2005 and 2004, the Company recorded several expense/(income) items that affected the comparability of results of the periods presented herein. For a discussion of these items, see Note 2 "Alliances and Investments;" Note 3 "Restructuring and Other Items;" Note 4 "Acquisitions and Divestitures;" Note 8 "Income Taxes;" Note 13 "Other Intangible Assets;" Note 14 "Short-Term Borrowings and Long-Term Debt;" and Note 21 "Legal Proceedings and Contingencies." The expense/(income) items that affected the comparability of results were as follows:

Year ended December 31, 2006

Dollars in Millions	Cost of products sold	Research and development	Marketing, selling and admin	Provision for restructuring, net	Litigation settlement expense / (income)	Other expense / (income), net	Gain on sale of product asset	Total
Litigation Matters:								
Pharmaceutical pricing and sales litigation	\$ —	\$ —	\$ —	\$ —	\$ 353	\$ —	\$ —	\$ 353
Product liability	—	—	—	—	—	11	—	11
Claim for damages	—	—	—	—	—	13	—	13
Commercial litigations	—	—	—	—	(14)	—	—	(14)
Insurance recovery	—	—	—	—	(37)	—	—	(37)
	—	—	—	—	302	24	—	326
Other:								
Debt retirement costs	—	—	—	—	—	220	—	220
Accelerated depreciation, asset impairment and contract termination	167	15	4	—	—	—	—	186
Upfront and milestone payments	—	70	—	—	—	—	—	70
Streamlining of worldwide operations	—	—	—	59	—	—	—	59
Gain on sale of product asset	—	—	—	—	—	—	(200)	(200)
	\$ 167	\$ 85	\$ 4	\$ 59	\$ 302	\$ 244	\$ (200)	661
Income taxes on items above								(149)
Change in estimate for taxes on prior year items								39
Reduction to Net Earnings from Continuing Operations								\$ 551

Year ended December 31, 2005

Dollars in Millions	Cost of products sold	Research and development	Provision for restructuring	Gain on sale of business	Litigation settlement expense / (income)	Other expense / (income), net	Total
Litigation Matters:							
Private litigation and governmental investigations	\$ —	\$ —	\$ —	\$ —	\$ 558	\$ —	\$ 558
ERISA liability and other matters	—	—	—	—	20	—	20
Pharmaceutical pricing and sales litigation	—	—	—	—	12	—	12
Insurance recoveries	—	—	—	—	(321)	—	(321)
	—	—	—	—	269	—	269
Other:							
Accelerated depreciation and asset impairment	96	14	—	—	—	—	110
Debt retirement costs	—	—	—	—	—	69	69
Streamlining of worldwide operations	1	14	32	—	—	—	47
Upfront and milestone payments	—	44	—	—	—	—	44
Loss on sale of fixed assets	—	—	—	—	—	18	18
Gain on sale of equity investment	—	—	—	—	—	(27)	(27)
Termination of muraglitazar agreement	5	—	—	—	—	(143)	(138)
Gain on sale of Consumer Medicines businesses	—	—	—	(569)	—	—	(569)
	\$ 102	\$ 72	\$ 32	\$ (569)	\$ 269	\$ (83)	(177)
Income taxes on items above							126
Adjustment on taxes on repatriation of foreign earnings							(135)
Increase to Net Earnings from Continuing Operations							\$ (186)

Year ended December 31, 2004

Dollars in Millions	Cost of products sold	Research and development	Acquired in-process research and development	Gain on sale of business	Provision for restructuring, net	Litigation settlement expense / (income)	Other expense / (income), net	Total
Litigation Matters:								
Private litigation and governmental investigations	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 336	\$ —	\$ 336
Product liability	75	—	—	—	—	—	11	86
Anti-trust litigation	—	—	—	—	—	50	—	50
Pharmaceutical pricing and sales litigation	—	—	—	—	—	34	—	34
Commercial litigation	26	—	—	—	—	—	—	26
Product liability insurance recovery	(25)	—	—	—	—	—	—	(25)
	76	—	—	—	—	420	11	507
Other:								
Accelerated depreciation	100	3	—	—	—	—	4	107
Streamlining of worldwide operations	1	—	—	—	104	—	—	105
Acordis IPR&D write-off	—	—	63	—	—	—	—	63
Upfront and milestone payments	—	55	—	—	—	—	—	55
Gain on sale of Adult Nutritional business	—	—	—	(320)	—	—	—	(320)
	\$ 177	\$ 58	\$ 63	\$(320)	\$ 104	\$ 420	\$ 15	517
Income taxes on items above								(130)
Deferred taxes in anticipation of repatriation of foreign earnings								575
Other tax adjustments								10
Reduction to Net Earnings from Continuing Operations								<u>\$ 972</u>

Earnings Before Minority Interest and Income Taxes

The Company's earnings before minority interest and income taxes were as follows:

Dollars in Millions	Earnings From Continuing Operations Before Minority Interest and Income Taxes			% Change	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Pharmaceuticals	\$ 2,559	\$ 3,732	\$ 4,334	(31)%	(14)%
Nutritionals	696	677	610	3%	11%
Other Health Care	517	469	510	10%	(8)%
Health Care Group	1,213	1,146	1,120	6%	2%
Total segments	3,772	4,878	5,454	(23)%	(11)%
Corporate/Other	(1,137)	(362)	(1,036)	**	65%
Total	\$ 2,635	\$ 4,516	\$ 4,418	(42)%	2%

** Change is in excess of 200%.

In 2006, earnings from continuing operations before minority interest and income taxes decreased 42% to \$2,635 million from \$4,516 million in 2005. The decrease was primarily driven by the net impact of items that affected the comparability of results as discussed above, lower net sales for pharmaceutical products resulting from lower Plavix net sales and loss of exclusivity of *Pravachol*, and increased spending on research and development, partially offset by an increase in equity in net income of affiliates and lower advertising and promotion expenses.

In 2005, earnings from continuing operations before minority interest and income taxes increased 2% to \$4,516 million from \$4,418 million in 2004. The increase was primarily a result of growth in the Nutritionals segment and the net impact of items that affected the comparability of results as discussed above, partially offset by lower sales and gross margin of pharmaceutical products, primarily due to exclusivity losses and increased spending on research and development, primarily for late-stage pharmaceutical compounds.

Pharmaceuticals

Earnings before minority interest and income taxes were \$2,559 million in 2006. The decrease in 2006 from 2005 was primarily due to lower net sales as a result of lower Plavix sales and loss of exclusivity of *Pravachol*, investment in research and development and continued investment in key growth drivers and new products. Earnings before minority interest and income taxes of \$3,732 million in 2005 decreased from \$4,334 million in 2004, primarily due to lower net sales and gross margin, primarily related to exclusivity losses, higher advertising and product promotion investments behind growth drivers and increased spending on research and development.

Health Care Group

Nutritionals

Earnings before minority interest and income taxes were \$696 million in 2006. The increase in 2006 from 2005 was primarily due to sales growth of children's nutritional products, partially offset by increased investments in advertising expense and research and development programs. Earnings before minority interest and income taxes of \$677 million in 2005 increased from \$610 million in 2004, primarily due to increased worldwide sales of infant formula products and international sales of toddler and children's nutritional products, partially offset by increased investments in advertising and product promotion, and research and development programs.

Other Health Care

Earnings before minority interest and income taxes were \$517 million in 2006. The increase in 2006 from 2005 was primarily driven by increased sales in the ConvaTec and Medical Imaging businesses. Earnings before minority interest and income taxes of \$469 million in 2005 decreased from \$510 million in 2004, primarily due to the sale of the Consumer Medicines business in the third quarter of 2005 and higher spending on research and development, partially offset by sales growth in the ConvaTec and Medical Imaging businesses.

Corporate/Other

Loss before minority interest and income taxes was \$1,137 million in 2006. The increase in 2006 from 2005 was primarily due to higher debt retirement costs in 2006 compared to 2005, lower gain on sale of a product asset in 2006 compared to the Consumer Medicines business in 2005, a \$143 million income in 2005 resulting from the termination of the muraglitazar collaborative agreement, as well as lower insurance recoveries in 2006 as compared to 2005, partially offset by lower litigation charges in 2006 compared to 2005. Loss before minority interest and income taxes in 2005 of \$362 million decreased from \$1,036 million in 2004, primarily due to the increase on the gain on the sales of businesses/product lines, deferred income recognized from the termination of the collaborative agreement for muraglitazar and a reduction of litigation charges, net.

Income Taxes

The effective income tax rate on earnings from continuing operations before minority interest and income taxes was 23.2% in 2006 compared with 20.6% in 2005 and 34.4% in 2004. The increase in the effective tax rate in 2006 compared to 2005 resulted from the elimination in 2006 of tax benefits under Section 936 of the Internal Revenue Code, the treatment of provisions for a portion of certain litigation reserves as non-deductible in 2006, tax benefits in 2005 associated with the settlement of an Internal Revenue Service (IRS) examination and a favorable adjustment in 2005 to taxes on special dividends under the American Jobs Creation Act of 2004 (AJCA), partially offset by favorable U.S. tax legislation enacted in 2006 related to the tax treatment of certain inter-company transactions amongst the Company's foreign subsidiaries, and the implementation of tax planning strategies in 2006 related to the utilization of certain charitable contributions. The decrease in the effective tax rate in 2005 was due primarily to a charge in 2004 of approximately \$575 million for taxes on special dividends under AJCA, a 2004 charge related to the establishment of a valuation allowance against certain charitable contributions and tax benefits in 2005 discussed above, partially offset by lower estimated foreign tax credits in 2005.

The Company has recorded significant deferred tax assets related to U.S. foreign tax credit carryforwards of approximately \$1,071 million and U.S. research tax credit carryforwards of approximately \$259 million, which expire in varying amounts beginning in 2012. Realization of the foreign tax credit and research tax credit carryforwards is dependent on generating sufficient domestic taxable income prior to their expiration. Although realization is not assured, management believes it is more likely than not that these deferred tax assets will be realized. The Company anticipates increasing its level of domestic profitability over time by undertaking actions such as increasing its biologics manufacturing capacity in the U.S. and implementing tax planning strategies. While increasing domestic profitability will likely cause the Company's effective tax rate to increase, it will also further enhance the Company's ability to utilize its foreign tax credit and research tax credit carryforwards. The amount of foreign tax credit and research tax credit carryforwards considered realizable, however, could be reduced in the near term if Plavix is subject to either renewed or additional generic competition. If such events occur, the Company may need to record significant valuation allowances against these U.S. Federal deferred tax assets. For a discussion of Plavix related matters, see Note 21 "Legal Proceedings and Contingencies."

The Company's U.S. Federal income tax returns for 2002 and 2003 are currently under examination by the IRS. The IRS has proposed (1) a significant disallowance of certain litigation settlement expenses and (2) a significant reduction in U.S. foreign tax credits claimed following the Company's previously disclosed 2002 international restructuring. The IRS' position on this latter matter also affects U.S. foreign tax credits claimed by the Company in 2004, although that year currently is not under examination. While the Company believes that it has very strong positions with respect to both issues and intends to contest the IRS' positions, it is not possible to predict the outcome of these issues. The Company has established tax contingency reserves that reflect the best estimate of the probable tax liability for these matters. If the Company were not to prevail in a final, non-appealable determination of these matters the amount of loss in excess of established reserves could have a material adverse effect on the Company's results of operations. However, the Company does not believe that such a determination would have a material adverse effect on its cash flows.

Minority Interest

In 2006, minority interest, net of taxes decreased to \$440 million from \$592 million in 2005, primarily due to lower earnings in the Company's partnership with Sanofi for the territory covering the Americas, resulting from the impact of the August 2006 at-risk launch of generic clopidogrel bisulfate.

Discontinued Operations

In May 2005, the Company completed the sale of OTN to One Equity Partners LLC for cash proceeds of \$197 million including the impact of a preliminary working capital adjustment. The Company recorded a pre-tax gain of \$63 million (\$13 million net of tax) that was presented as a gain on sale of discontinued operations in the consolidated statement of earnings. OTN was previously presented as a separate segment. For further discussions of OTN, see Note 5 "Discontinued Operations."

The amounts related to the OTN business have been segregated from continuing operations and are reflected as discontinued operations for all periods presented. The amounts related to the OTN business were as follows:

Dollars in Millions	Year ended December 31,		
	2006	2005	2004
Net sales	\$ —	\$ 1,015	\$ 2,506
Loss before income taxes	—	(8)	15
Loss, net of taxes	—	(5)	10

Financial Position, Liquidity and Capital Resources

Cash, cash equivalents and marketable securities were approximately \$4.0 billion at December 31, 2006, compared to \$5.8 billion at December 31, 2005. The Company continues to maintain a sufficient level of working capital, which was approximately \$3.8 billion at December 31, 2006, decreasing from \$5.4 billion at December 31, 2005.

As noted above, there have been recent developments in the pending patent litigation involving Plavix, including the generic launch by Apotex in August 2006, which currently is subject to a preliminary injunction that has halted sales by Apotex. The trial in the underlying patent litigation ended on February 15, 2007 and the Court is expected to rule following post-trial briefing. If Apotex were to prevail at trial, the Company would expect that Plavix would face renewed generic competition promptly thereafter. Subject to these risks, the Company currently believes that, in the absence of renewed or additional generic competition for Plavix from other generic pharmaceutical companies, in 2007 and future periods, cash generated by its U.S. operations, together with existing cash and borrowings from the capital markets, to be sufficient to cover cash needs for working capital, capital expenditures (which the Company expects to include substantial investments in facilities to increase and maintain the Company's capacity to provide biologics on a commercial scale), milestone payments and dividends paid in the U.S. Cash and cash equivalents, marketable securities, the conversion of other working capital items and borrowings are expected to fund near-term operations.

Under any circumstances, renewed or additional generic competition for Plavix would be material to the Company's sales of Plavix and results of operations and cash flows, and could be material to the Company's financial condition and liquidity. Additional information about the pending Plavix patent litigation and the recent adverse developments is included in "—Executive Summary—Plavix" above and Note 21 "Legal Proceedings and Contingencies—Intellectual Property—Plavix Litigation."

In the fourth quarter of 2004, the Company disclosed that it anticipated repatriating approximately \$9 billion in special dividends in 2005 and recorded a \$575 million provision for deferred income taxes pursuant to the AJCA as enacted and other pending matters. The Company repatriated approximately \$6.2 billion from foreign subsidiaries in the first quarter of 2005 and repatriated the remaining balance of approximately \$2.8 billion in the fourth quarter of 2005. The Company has used and expects to continue to use the special dividends in accordance with requirements established by the AJCA and the U.S. Treasury Department. During the second quarter of 2005, the U.S. Treasury Department issued AJCA related guidance clarifying that the "gross-up" for foreign taxes associated with the special dividends also qualifies for the 5.25% tax rate established by the AJCA. As a result of this

guidance, the Company reduced the \$575 million provision by recording a benefit of approximately \$135 million in its tax provision for 2005. Except for earnings associated with the special dividends discussed above, U.S. income taxes have not been provided on the balance of unremitted earnings of non-U.S. subsidiaries, since the Company has invested or expects to invest such earnings permanently offshore.

As of December 31, 2006, the Company had approximately \$11.3 billion of undistributed earnings of foreign subsidiaries for which taxes have not been provided as the Company has invested or expects to invest these undistributed earnings permanently offshore. If in the future these earnings are repatriated to the U.S., or if the Company determines such earnings will be remitted in the foreseeable future, additional tax provisions would be required. Due to complexities in the tax laws and the assumptions that would have to be made, it is not practicable to estimate the amounts of income taxes that would have to be provided.

Cash and cash equivalents at December 31, 2006 primarily consisted of U.S. dollar denominated bank deposits with an original maturity of three months or less. Marketable securities at December 31, 2006 primarily consisted of U.S. dollar denominated floating rate instruments with an 'AAA/aaa' credit rating. Due to the nature of these instruments, the Company considers it reasonable to expect that their fair market values will not be significantly impacted by a change in interest rates, and that they can be liquidated for cash at short notice. The average interest yield on invested cash and cash equivalents was 5.2% and 4.1% at December 31, 2006 and 2005, respectively, while interest yields on marketable securities averaged 5.3% and 4.4%, respectively.

In September 2006, the Company and Sanofi each posted \$200 million towards a \$400 million bond with the Court as collateral in support of the preliminary injunction. The Company has pledged to the issuer of the bond collateral for its \$200 million bond consisting of short-term, high quality securities. This collateral is reported as marketable securities on the Company's consolidated balance sheet at December 31, 2006. Under the terms of the pledge agreement, the Company is entitled to receive the income generated from the marketable securities and to make certain investment strategy decisions, but is restricted from using the \$200 million pledged securities for any other purpose until such time as the bond is cancelled.

In December 2006, the Company completed the sale and leaseback of several administrative facilities in New Jersey for \$283 million. The resulting pre-tax gain from the transaction of \$154 million was deferred and will reduce future lease rental costs over the lease periods ranging from 8 to 12 years.

Short-term borrowings at the end of 2006 and 2005 were \$187 million and \$231 million, respectively. The Company maintains cash balances and short-term investments in excess of short-term borrowings.

Long-term debt was \$7.2 billion at December 31, 2006 compared to \$8.4 billion at December 31, 2005. During the fourth quarter of 2006, the Company restructured its long-term debt by retiring all of its outstanding \$2.5 billion principal amount of 5.75% Notes due 2011, through a cash tender offer and subsequent redemption and issuing €500 million aggregate principal of 4.375% Notes due 2016, €500 million aggregate principal of 4.625% Notes due 2021, as well as \$1.25 billion aggregate principal of 5.875% Notes due 2036. The Company incurred an aggregate pre-tax expense of approximately \$220 million in connection with the early redemption of the 2011 Notes and termination of related interest rate swaps, which included the write-off of the related unamortized discount, issuance costs and deferred loss on an interest rate lock. Long-term debt at December 31, 2006 also included Japanese yen debt of 19.4 billion Yen.

In December 2006, the Company replaced its prior \$2 billion revolving credit facility with a new \$2 billion five year revolving credit facility from a syndicate of lenders, which is extendable on the anniversary date with the consent of the lenders. This facility contains customary terms and conditions substantially similar to the prior facility, including a financial covenant whereby the ratio of consolidated debt to consolidated capital cannot exceed 50% at the end of each quarter. The Company has been in compliance with this covenant since the inception of this new facility. There were no borrowings outstanding under the revolving credit facility at December 31, 2006.

In August 2005, a wholly-owned subsidiary of the Company entered into a new \$2.5 billion term loan facility with a syndicate of lenders. Borrowings under this facility are guaranteed by the Company, the subsidiaries of the borrower and by certain European subsidiaries of the Company. This facility contains a five-year tranche of up to \$2.0 billion and a two-year tranche of up to \$500 million and was fully drawn at December 31, 2005. During the fourth quarter of 2006, the Company repaid the entire \$500 million of the two-year tranche and \$700 million of the five-year tranche. The Company is subject to substantially the same covenants as those included in its December 2004 Revolving Credit facility. The Company is also subject to further restrictions, including certain financial covenants. Prior to borrowing any proceeds against the facility in 2005, the Company obtained a waiver from the lenders for a covenant default under this facility due to a one-time intercompany distribution. At December 31, 2006, the Company was in full compliance with all covenants.

During the second quarter of 2005, the Company repurchased all of its outstanding \$2.5 billion aggregate principal amount 4.75% Notes due 2006, and incurred an aggregate pre-tax loss of approximately \$69 million in connection with the early redemption of the Notes and termination of related interest rate swaps.

A majority of the Company's debt is fixed rate. The Company, however, has entered into fixed to floating interest rate swaps for \$3.9 billion of its long-term debt, including €1 billion Euro. Interest expense, net of interest swap gains, was \$498 million, \$349 million, and \$310 million, in 2006, 2005 and 2004, respectively. The increase in interest expense in 2006 from 2005 and in 2005 from 2004 was primarily due to higher interest rates.

The Moody's Investors Service (Moody's) long-term and short-term credit ratings for the Company are currently A2 and Prime-1, respectively, following a downgrade of the long-term credit rating during the third quarter of 2006 from A1. Moody's long-term credit rating was amended from negative outlook to stable outlook in the third quarter of 2006. Standard & Poor's (S&P) long-term and short-term credit ratings for the Company are currently A+ and A-1, respectively. S&P's long-term credit rating remains on negative outlook. Fitch Ratings (Fitch) long-term and short-term credit ratings for the Company are currently A+ and F1, respectively. Fitch has placed the Company on *Rating Watch Negative*.

Working capital for the years ended December 31, 2006 and 2005 were as follows:

Dollars in Millions	December 31,	
	2006	2005
Working capital	\$ 3,806	\$ 5,393

The decrease in working capital of \$1,587 million from December 31, 2005 to December 31, 2006 was impacted by:

- Decrease in cash and marketable securities, primarily due to the repayment of long-term debt.
- Lower receivables, primarily due to lower Plavix sales and the loss of exclusivity of *Pravachol*, mostly offset by higher receivables due from alliance partners.
- Increase in inventories to support growth drivers and recently launched products, mostly offset by a reduction of *Pravachol* inventory resulting from loss of exclusivity.
- Reduction in deferred tax assets in 2006, primarily due to litigation settlement payments.
- Lower accounts payable due to lower purchases of *Pravachol* raw materials.
- Increase in deferred income resulting from higher deferred alliance revenue.
- Lower accrued rebates and returns, primarily due to exclusivity loss of *Pravachol*, volume erosion on highly rebated *Paraplatin* and *TAXOL*[®] (paclitaxel) and lower Plavix volumes, partially offset by higher sales returns.

Cash flow activities for the years ended December 31, 2006, 2005 and 2004 were as follows:

Dollars in Millions	Year Ended December 31,		
	2006	2005	2004
Cash flow provided by/(used in):			
Operating activities	\$ 2,083	\$ 1,836	\$ 3,176
Investing activities	206	1,191	(1,622)
Financing activities	(3,351)	(3,637)	(463)

Net cash provided by operating activities was \$2.1 billion in 2006 and \$1.8 billion in 2005. The \$247 million increase in 2006 compared to 2005 is mainly attributable to significant changes in adjustments to net earnings of \$1,398 million and net changes in operating assets and liabilities of \$264 million, offset by lower net earnings of \$1,415 million.

Significant positive changes in adjustments to net earnings in 2006 compared to 2005, of \$1,398 million, mainly included:

- A \$576 million positive cash flow variance in the deferred income tax expense/(benefit), due to a lower level of increase in deferred tax benefit in 2006 compared to 2005. In 2006, there was an increase in deferred tax benefits associated with U.S. research and development, foreign tax credits and an increase in litigation reserves. In 2005, there was an increase in deferred tax benefits associated with the reversal of the tax liability related to the repatriation of special dividends under the AJCA.
- A \$425 million positive cash flow variance, due to lower gain on sale of a product asset in 2006 as compared to sale of a business in 2005.
- A \$143 million positive cash flow variance for deferred income recognized related to the termination of the muraglitazar collaborative agreement in 2005.

Net positive changes in operating assets and liabilities in 2006 compared to 2005, of \$264 million, mainly included:

- A \$329 million negative cash flow variance from receivables. In 2006, the increase in cash flow was driven by increases in receivables due from alliance partners, which were partially offset by lower trade receivable volume. In 2005, the increase in cash flow was driven by the collection of foreign withholding taxes and from alliance partners.
- A \$448 million positive cash flow variance from inventories, primarily due to an increase in inventories in 2005 resulting from the growth of newer products and in anticipation of new product launches, and the reduction in inventories in 2006 resulting from *Pravachol* exclusivity loss.
- A \$283 million negative cash flow variance in litigation, primarily due to settlement payments of \$339 million in 2006 for the DPA and the *Vanlev* litigation, which were partially offset by unrelated insurance recoveries of \$67 million.
- A \$443 million positive cash flow variance from income taxes payable, primarily related to payments in 2005 for the settlement of examinations by the IRS for years 1998 through 2001 and the repatriation of special dividends under AJCA.

Net cash provided by investing activities was \$206 million in 2006 compared to net cash provided of \$1,191 million in 2005. The \$985 million negative cash flow variance was primarily attributable to:

- A \$281 million negative cash flow variance mainly from the sale of marketable securities in 2005.
- A \$617 million negative cash flow variance from lower proceeds from the sale of a product asset in 2006 compared to the sale of the Consumer Medicines and OTN businesses in 2005.
- A \$280 million negative cash flow variance from milestone payments in 2006 primarily related to ImClone.
- A \$281 million positive cash flow variance for proceeds from the disposal of properties in connection with a sale and lease back transaction in 2006.

Net cash used in financing activities was \$3,351 million in 2006 compared to \$3,637 million in 2005. The \$286 million positive cash flow variance was mainly attributable to:

- A \$1,655 million positive cash flow variance from the repayment of short-term borrowings in 2005.
- A \$1,198 negative cash flow variance from the retirement of long-term debt. In 2006, the Company repaid debt of \$1,200 million and retired the 5.75% Notes due 2011 for \$2,425 million. In 2005, the Company retired the 4.75% Notes due 2006 for \$2,507 million.

Net cash provided by operating activities was \$1.8 billion in 2005 and \$3.2 billion in 2004. The \$1,340 million decrease in 2005 compared to 2004 was mainly attributable to significant changes in adjustments to net earnings of \$1,648 million and net changes in operating assets and liabilities of \$304 million, offset by higher net earnings of \$612 million.

Significant negative changes in adjustments to net earnings in 2005 compared to 2004, of \$1,648 million, mainly included:

- A \$1,090 million negative cash flow variance, due primarily to the reversal of the \$575 million AJCA deferred tax provision recorded in 2004.
- A \$151 million negative cash flow variance, due to lower litigation settlement expenses in 2006.
- A \$312 million negative cash flow variance, due to a higher gain on sale of businesses in 2005 as compared to 2004.

Net changes in operating assets and liabilities in 2005 compared to 2004, of \$304 million, mainly included:

- A \$1,095 million positive cash flow variance from receivables. The increase in cash flow from receivables was driven by lower sales volume in 2005 and an increase in foreign withholding taxes receivable in 2004.
- A \$511 million positive cash flow variance, primarily due to lower litigation settlement payments as well as insurance recoveries in 2005.
- A \$626 million negative cash flow variance from accounts payable and accrued expenses, primarily due to vendor payments prior to the sale of the OTN business in 2005 and lower accrued rebates and returns in 2005 as compared to 2004.
- A \$762 million negative cash flow variance from income taxes payable, primarily related to payments in 2005 for the settlement of examinations by the IRS for years 1998 through 2001 and the repatriation of special dividends under AJCA.

Net cash provided by investing activities was \$1,191 million in 2005 compared to net cash used of \$1,622 million in 2004. The \$2,813 million positive cash flow variance was primarily attributable to:

- A \$1,822 million positive cash flow variance mainly from the sale of marketable securities in 2005 compared with purchases in 2004.
- A \$479 million positive cash flow variance from higher proceeds from the sale of the Consumer Medicines and OTN businesses in 2005 compared with the sale of the Adult Nutritionals business in 2004.
- A \$250 million positive cash flow variance, due to a milestone payment in 2004 to ImClone.
- A \$150 million positive cash flow variance, due to the purchase of Acordis Specialty Fibres in 2004.

Net cash used in financing activities was \$3,637 million in 2005 compared to \$463 million in 2004. The \$3,174 million negative cash flow variance was mainly attributable to:

- A \$3,183 million negative cash flow variance from the retirement of commercial paper in 2005 compared to purchases in 2004.
- A \$2,500 million negative cash flow variance, due to the 2005 repurchase of the \$2.5 billion 4.75% Notes due 2006.
- A \$2,500 million positive cash flow variance from proceeds from borrowings against the new term loan facility in 2005.

Cash provided from operations and borrowings were primarily used over the past three years to pay dividends of approximately \$6.6 billion. The Company has also invested approximately \$2.2 billion over the past three years in capital expansion to improve plant efficiency and maintain superior research facilities.

Over the past three years, the Company did not repurchase any of its common stock. The total shares acquired since the share repurchase program's inception is 372 million shares. The share repurchase program authorizes the Company to purchase common stock from time to time in the open market or through private transactions as market conditions permit. This program is intended to reduce the increase in shares outstanding from option exercises and to obtain shares for general corporate purposes.

Dividends declared per common share were \$1.12 for each of 2006, 2005 and 2004. In December 2006, the Company declared a quarterly dividend of \$.28 per common share and indicated a dividend for the full year 2007 of \$1.12 per share. Dividend decisions are made on a quarterly basis by the Company's Board of Directors.

The Company's financial condition and liquidity could be affected by obligations to make milestone or other one-time payments and by the outcome of pending litigations and investigations, including the challenge to the Plavix patent and/or the potential for renewed or additional generic competition for Plavix. For more information, see Note 2 "Alliances and Investments" and Note 21 "Legal Proceedings and Contingencies."

Contractual Obligations

Payments due by period for the Company's contractual obligations at December 31, 2006, were as follows:

Dollars in Millions	Obligations Expiring by Period						
	Total	2007	2008	2009	2010	2011	Later Years
Short-term borrowings	\$ 187	\$ 187	\$ —	\$ —	\$ —	\$ —	\$ —
Long-term debt ⁽¹⁾	7,248	—	1,735	—	1,329	—	4,184
Operating leases	714	141	120	97	70	63	223
Purchase obligations	2,728	505	464	412	399	382	566
Stand-by letters of credit/performance guarantees	165	105	48	1	—	—	11
Pension and other liabilities	1,589	135	196	153	150	147	808
Total	\$ 12,631	\$ 1,073	\$ 2,563	\$ 663	\$ 1,948	\$ 592	\$ 5,792

(1) The current portion of long-term debt obligations is included in short-term borrowings on the Company's consolidated balance sheet at December 31, 2006 and all balances approximate the outstanding nominal long-term debt values. The contractual obligations table above excludes interest payment obligations. The Company's convertible debenture is included as due for payment in 2008, as it contains a 2008 put and call feature.

In addition to the above, the Company has committed to make potential future "milestone" payments to third-parties as part of in-licensing and development programs. Payments under these agreements generally become due and payable only upon achievement of certain developmental, regulatory and/or commercial milestones. Because the achievement of these milestones is neither probable nor reasonably estimable, such contingencies have not been recorded on the Company's consolidated balance sheet.

For a discussion of contractual obligations, see Note 14 "Short-Term Borrowings and Long-Term Debt;" Note 17 "Financial Instruments;" Note 19 "Leases;" and Note 20 "Pension and Other Postretirement Benefit Plans."

SEC Consent Order and Deferred Prosecution Agreement

As previously disclosed, on August 4, 2004, the Company entered into a final settlement with the SEC, concluding an investigation concerning certain wholesaler inventory and accounting matters. The settlement was reached through a Consent, a copy of which was attached as Exhibit 10 to the Company's quarterly report on Form 10-Q for the period ended September 30, 2004.

Under the terms of the Consent, the Company agreed, subject to certain defined exceptions, to limit sales of all products sold to its direct customers (including wholesalers, distributors, hospitals, retail outlets, pharmacies and government purchasers) based on expected demand or on amounts that do not exceed approximately one month of inventory on hand, without making a timely public disclosure of any change in practice. The Company also agreed in the Consent to certain measures that it has implemented including: (a) establishing a formal review and certification process of its annual and quarterly reports filed with the SEC; (b) establishing a business risk and disclosure group; (c) retaining an outside consultant to comprehensively study and help re-engineer the Company's accounting and financial reporting processes; (d) publicly disclosing any sales incentives offered to direct customers for the purpose of inducing them to purchase products in excess of expected demand; and (e) ensuring that the Company's budget process gives appropriate weight to inputs that come from the bottom to the top, and not just those that come from the top to the bottom, and adequately documenting that process.

Further, the Company agreed in the Consent to retain an "Independent Advisor" through the date that the Company's Form 10-K for the year ended 2005 was filed with the SEC. The Independent Advisor continues to serve as the Monitor under the DPA discussed below.

As previously disclosed, on June 15, 2005, the Company entered into a DPA with the USAO for the District of New Jersey resolving the investigation by the USAO of the Company relating to wholesaler inventory and various accounting matters covered by the Company's settlement with the SEC. Pursuant to the DPA, the USAO filed a criminal complaint against the Company alleging conspiracy to commit securities fraud, but will defer prosecution of the Company and dismiss the complaint after two years if the Company satisfies all of the requirements of the DPA. A copy of the DPA was filed as Exhibit 99.2 to a Form 8-K filed by the Company on June 16, 2005.

Under the DPA, among other things, the Company agreed to include in its Forms 10-Q and 10-K filed with the SEC and in its annual report to shareholders the following information: (a) estimated wholesaler/direct customer inventory levels of the top fifteen (15) products sold by the U.S. Pharmaceuticals business; (b) for major non-U.S. countries, estimated aggregate wholesaler/direct-customer inventory levels of the top fifteen (15) pharmaceutical products sold in such countries taken as a whole measured by aggregate annual sales in such countries; (c) arrangements with and policies concerning wholesaler/direct customers and other distributors for these products, including efforts by the Company to control and monitor wholesaler/distributor inventory levels; and (d) data concerning prescriptions or other measures of end-user demand for these products. Pursuant to the DPA, the Company also agreed to include in such filings and reports information on acquisition, divestiture, and restructuring reserve policies and activity, and rebate accrual policies and activity.

The Company also agreed to implement remedial measures already undertaken or mandated in the Consent and in the settlements of the derivative litigation and the Federal securities class action relating to wholesaler inventory and various accounting matters. In addition, the Company agreed to undertake additional remedial actions, corporate reforms and other actions, including: (a) appointing an additional non-executive Director acceptable to the USAO; (b) establishing and maintaining a training and education program on topics that include corporate citizenship and financial reporting obligations; (c) making an additional \$300 million payment into the shareholder compensation fund established in connection with the Consent; (d) not engaging in or attempting to engage in any criminal conduct as that term is defined in the DPA; (e) continuing to cooperate with the USAO, including with respect to the ongoing investigation regarding individual current and former employees of the Company; and (f) retaining a Monitor. Also as part of the DPA, the Board of Directors (the Board) separated the roles of Chairman and Chief Executive Officer (CEO) of the Company and on June 15, 2005, elected a Non-Executive Chairman.

As noted above under the DPA, the Company agreed to not engage or attempt to engage in criminal conduct. "Criminal conduct" is defined under the DPA as (a) any crime related to the Company's business activities committed by one or more executive officers or directors; (b) securities fraud, accounting fraud, financial fraud or other business fraud materially affecting the books and records of publicly filed reports of the Company, and (c) obstruction of justice. The USAO, in its discretion, may prosecute the Company for any Federal crimes for which the USAO has knowledge, including the matters that were the subject of the criminal complaint referenced above, should the USAO determine that the Company committed any criminal conduct.

The Monitor has defined powers and responsibilities under the DPA, including the responsibility at least until April 2007 to oversee the Company's compliance with all of the terms of the DPA, the Consent and the settlements of the derivative action and the Federal securities class action. The Monitor has the authority to require the Company to take any steps he believes necessary to comply with the terms of the DPA and the Company is required to adopt all recommendations made by the Monitor, unless the

Company objects to the recommendation and the USAO agrees that adoption of the recommendation should not be required. In addition, the Monitor reports to the USAO, on at least a quarterly basis, as to the Company's compliance with the DPA and the implementation and effectiveness of the internal controls, financial reporting, disclosure processes and related compliance functions of the Company.

On September 12, 2006, the Board announced that the Company's then current CEO and General Counsel would be leaving their respective positions effective immediately. The announcement took place after the Board received and considered reports from the Company's outside counsel on issues relating to the Plavix patent litigation with Apotex and a preliminary recommendation from the Monitor to terminate the employment of such individuals. The Monitor's recommendation followed an investigation initiated by the USAO, conducted by the Monitor and the USAO, into corporate governance issues relating to the Company's negotiations on a proposed settlement with Apotex. The Company had been advised by the Monitor and the USAO that the investigation did not involve matters that are the subject of the ongoing investigation by the Antitrust Division of the Department of Justice into the Plavix settlement agreement. At the time the Monitor made his preliminary recommendation, the Monitor and the USAO also advised the Company that they had not found a violation of the DPA or any unlawful conduct by the Company or its employees. The investigation included a review of whether there was any violation of Federal securities laws in connection with the proposed settlement with Apotex under the terms of the SEC Consent. The Monitor has completed his investigation and submitted his report on the investigation to the USAO. The Monitor's report did not find any violation of the Consent or the Federal securities laws in connection with the proposed settlement. The Monitor concluded that the Company had violated certain paragraphs of the DPA related to governance matters. The violations cited by the Monitor in his report relate, among other things, to communication failures, including insufficient communications by the Company's former CEO and former General Counsel with the Board and with other members of senior management, as well as failure to comply with certain internal Company policies and procedures. The Monitor did not make any findings with respect to whether the Company knowingly and materially breached the DPA or make any recommendations. The USAO has advised the Company that he believes the matters cited in the Monitor's report have been fully remediated and, accordingly, that he does not intend to take any action under the DPA with respect to the Monitor's report. For additional information on the pending Plavix patent litigation and the Antitrust Division investigation, see Note 21 "Legal Proceedings and Contingencies."

The Company has established a company-wide policy to limit its sales to direct customers for the purpose of complying with the Consent. This policy includes the adoption of various procedures to monitor and limit sales to direct customers in accordance with the terms of the Consent. These procedures include a governance process to escalate to appropriate management levels potential questions or concerns regarding compliance with the policy and timely resolution of such questions or concerns. In addition, compliance with the policy is monitored on a regular basis.

The Company maintains IMAs with most of its U.S. pharmaceutical wholesalers that account for nearly 100% of total gross sales of U.S. pharmaceutical products. Under the current terms of the IMAs, the Company's three largest wholesaler customers provide the Company with weekly information with respect to months on hand product level inventories and the amount of out-movement of products. These three wholesalers currently account for 90% of total gross sales of U.S. pharmaceutical products in 2006, 2005 and 2004. The inventory information received from these wholesalers, together with the Company's internal information, is used to estimate months on hand product level inventories at these wholesalers. The Company estimates months on hand product inventory levels for its U.S. Pharmaceuticals business's wholesaler customers other than the three largest wholesalers by extrapolating from the months on hand calculated for the three largest wholesalers. The Company considers whether any adjustments are necessary to these extrapolated amounts based on such factors as historical sales of individual products made to such other wholesalers and third-party market research data related to prescription trends and patient demand. In contrast, for the Company's Pharmaceuticals business outside of the U.S., Nutritionals and Other Health Care business units around the world, the Company has significantly more direct customers, limited information on direct customer product level inventory and corresponding out-movement information and the reliability of third-party demand information, where available, varies widely. Accordingly, the Company relies on a variety of methods to estimate months on hand product level inventories for these business units.

The Company discloses for each of its top fifteen (15) pharmaceutical products (based on 2005 net sales) and pharmaceutical products that the Company views as current and future growth drivers sold by the U.S. Pharmaceuticals business the amount of net sales and the estimated number of months on hand in the U.S. wholesaler distribution channel as of the end of the immediately preceding quarter and as of the end of the applicable quarter, as well as corresponding information for the prior year in its quarterly and annual reports on Forms 10-Q and 10-K. The Company discloses corresponding information for the top fifteen pharmaceutical products and pharmaceutical products that the Company views as current and future growth drivers sold within its major non-U.S. countries, as described above. For all other business units, the Company discloses on a quarterly basis the key product level inventories. The information required to estimate months on hand product level inventories in the direct customer distribution for the non-U.S. Pharmaceuticals businesses is not available prior to the filing of the quarterly report on Form 10-Q for an applicable quarter. Accordingly, the Company discloses this information on its website approximately 60 days after the end of the applicable quarter and furnishes it on Form 8-K, and in the Company's Form 10-Q for the following quarter. In addition to the foregoing quarterly disclosure,

the Company will include all the foregoing information for all business units for the immediately preceding quarter and of the applicable quarter as well as corresponding information for the prior year in its Annual Report on Form 10-K. For products not described above, if the inventory at direct customers exceeds approximately one month on hand, the Company will disclose the estimated months on hand for such product(s), except where the impact on the Company is de minimis.

The Company has enhanced and will continue to seek to enhance its methods to estimate months on hand product inventory levels for the U.S. Pharmaceuticals business and for the non-U.S. Pharmaceuticals businesses around the world, taking into account the complexities described above. The Company also has taken and will continue to take steps to expedite the receipt and processing of data for the non-U.S. Pharmaceuticals businesses.

The Company believes the above-described procedures provide a reasonable basis to ensure compliance with both the Consent and the DPA and provides sufficient information to comply with disclosure requirements of both.

Recently Issued Accounting Standards

The Company adopted SFAS No. 123(R), *Share-Based Payment*, which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors based on estimated fair values. SFAS No. 123(R) supersedes the Company's previous accounting under APB No. 25, *Accounting for Stock Issued to Employees*, for periods beginning January 1, 2006. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment*, relating to SFAS No. 123(R). The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, and has elected the alternative method as provided in FASB Staff Position (FSP) No. 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*, in determining the Company's pool of excess tax benefits. The Company's consolidated financial statements for the year ended December 31, 2006 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Stock-based compensation expense recognized under SFAS No. 123(R) for the year ended December 31, 2006 was \$112 million (\$73 million, net of tax) or \$0.04 per share, with a corresponding amount recorded in additional paid-in capital within stockholders' equity. Additionally, \$10 million related to performance awards was reclassified from liabilities to stockholders' equity in connection with the adoption of SFAS No. 123(R).

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits an entity to measure certain financial assets and financial liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option (by instrument) will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option election is irrevocable, unless a new election date occurs. SFAS No. 159 establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. This Statement is effective for fiscal years beginning after November 15, 2007. The Company is evaluating the potential impact of this pronouncement.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. This pronouncement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. This pronouncement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The pronouncement does not require prior periods to be restated to reflect the impact of SFAS No. 158. The Company adopted SFAS No. 158 in the fiscal year ended December 31, 2006 and the adoption of this accounting pronouncement resulted in a \$1,064 million reduction of accumulated other comprehensive income in stockholders' equity, a \$767 million reduction in total assets and a \$297 million increase in total liabilities. The adoption of SFAS No. 158 did not impact the Company's results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This pronouncement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement is effective for fiscal years beginning after November 15, 2007. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying the Misstatements in Current Year Financial Statements*, that expresses the staff's views regarding the process of quantifying financial statement misstatements. This bulletin is effective for any interim period of the first fiscal year ending after November 15, 2006. SAB No. 108 requires that companies utilize a "dual approach" to assess the quantitative effects of financial statement misstatements. The dual approach includes both an income statement focus and balance sheet focus assessment. The adoption of this bulletin did not have any effect on the Company's consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, which, in the case of the Company, is effective as of January 1, 2007. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN No. 48 requires that all tax positions be evaluated using a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Differences between tax positions taken in a tax return and amounts recognized in the financial statements are recorded as adjustments to income taxes payable or receivable, or adjustments to deferred taxes, or both. FIN No. 48 also requires expanded disclosure at the end of each annual reporting period including a tabular reconciliation of unrecognized tax benefits. In accordance with FIN No. 48, the Company will report the difference between the net amount of assets and liabilities recognized in the statement of financial position prior to and after the application of FIN No. 48 as a cumulative effect adjustment to the opening balance of retained earnings. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*. This pronouncement relates to the accounting for separately recognized servicing assets and servicing liabilities. This Statement is effective for fiscal years beginning after September 15, 2006. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140*. This pronouncement primarily resolves certain issues addressed in the implementation of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, concerning beneficial interests in securitized financial assets. The Statement is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of the 2007 fiscal year. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. This pronouncement applies to all voluntary changes in accounting principle, and revises the requirements for accounting for and reporting a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable to do so. This pronouncement also requires that a change in the method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS No. 154. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

In March 2005, the FASB issued FIN No. 47, *Accounting for Conditional Asset Retirement Obligations*. FIN No. 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. Asset retirement obligations covered by FIN No. 47 are those for which an entity has a legal obligation to perform an asset retirement activity, even if the timing and method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

In December 2004, the FASB issued FSP No. 109-1— *Application of SFAS No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. FSP No. 109-1 provides that the *Deduction on Qualified Production Activities* will be treated as a "special deduction" as described in SFAS No. 109, *Accounting for Income Taxes*. Accordingly, the tax effect of this deduction was reported as a component of the Company's tax provision and did not have an effect on deferred tax assets and liabilities. On May 24, 2006, the IRS issued Final Tax Regulations (FTR) with respect to the *Deduction on Qualified Production Activities* under Section 199 of the Internal Revenue Code. The final regulations are effective for taxable years beginning on or after June 1, 2006. The adoption of the FTR and FSP No. 109-1 did not have a material impact on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The provisions of this Statement should be applied prospectively, and eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs – an Amendment of ARB No. 43, Chapter 4*. The pronouncement requires abnormal amounts of idle facility and related expenses to be recognized as current period charges and also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

Critical Accounting Policies

The Company prepares its financial statements in conformity with accounting principles generally accepted in the U.S. The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP) requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosure of contingent assets and contingent liabilities, at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The Company's critical accounting policies are those that are both most important to the Company's financial condition and results of operations and require the most difficult, subjective or complex judgments on the part of management in their application, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Because of the uncertainty of factors surrounding the estimates or judgments used in the preparation of the consolidated financial statements, actual results may vary from these estimates.

The Company believes that the following discussion represents its critical accounting policies. Management has discussed the Company's critical accounting policies with the Audit Committee of the Board of Directors.

Revenue Recognition

The Company recognizes revenue in accordance with SAB No. 101, *Revenue Recognition in Financial Statements*, as amended by SAB No. 104, *Revenue Recognition*. The Company's accounting policy for revenue recognition has a substantial impact on its reported results and relies on certain estimates that require difficult, subjective and complex judgments on the part of management. The Company recognizes revenue when substantially all the risks and rewards of ownership have transferred to the customer, which generally occurs on the date of shipment, with the exceptions described below.

In previous years, certain transactions with the Company's U.S. pharmaceutical wholesalers were accounted for using the consignment model. In the case of sales made to wholesalers (1) as a result of incentives, (2) in excess of the wholesaler's ordinary course of business inventory level, (3) at a time when there was an understanding, agreement, course of dealing or consistent business practice that the Company would extend incentives based on levels of excess inventory in connection with future purchases, and (4) at a time when such incentives would cover substantially all, and vary directly with, the wholesaler's cost of carrying inventory in excess of the wholesaler's ordinary course of business inventory level, substantially all the risks and rewards of ownership did not transfer upon shipment, and accordingly, such sales were accounted for using the consignment model. The determination of when, if at all, sales to a wholesaler meet the foregoing criteria involves evaluation of a variety of factors and a number of complex judgments. Under the consignment model, the Company does not recognize revenue upon shipment of product. Rather, upon shipment of product, the Company invoices the wholesalers, records deferred revenue at gross invoice sales price, and classifies the inventory held by the wholesalers as consignment inventory at the Company's cost of such inventory. The Company recognizes revenue (net of the gross-to-net sales adjustments discussed below, all of which involve significant estimates and judgments) when the consignment inventory is no longer subject to incentive arrangements, but not later than when such inventory is sold through to the wholesalers' customers, on a first-in first-out basis (FIFO).

In the case of new products for which the product introduction is not an extension of an existing line of product, where the Company determines that there are not products in a similar therapeutic category, or where the Company determines the new product has dissimilar characteristics with existing products, such that the Company cannot reliably estimate expected returns of the new product, the Company defers recognition of revenue until the right of return no longer exists or until the Company has developed sufficient historical experience to estimate sales returns.

For discussions on revenue recognition, see Note 1 "Accounting Policies—Revenue Recognition and Sales Rebate and Return Accruals."

Gross-to-Net Sales Adjustments

The Company has the following significant categories of gross-to-net sales adjustments: prime vendor charge-backs, WIC rebates, managed health care rebates and other contract discounts, Medicaid rebates, cash discounts, sales returns, and other adjustments, all of which involve significant estimates and judgments and require the Company to use information from external sources. The Company accounts for these gross-to-net sales adjustments in accordance with Emerging Issues Task Force Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*, and SFAS No. 48, *Revenue Recognition When Right of Return Exists*, as applicable. See “—Net Sales” section above for a reconciliation of the Company’s gross sales to net sales by each significant category of gross-to-net sales adjustment.

Prime vendor charge-backs

The Company’s U.S. businesses participate in prime vendor programs with government entities, the most significant of which are the U.S. Department of Defense and the U.S. Department of Veterans Affairs, and other parties whereby pricing on products is extended below wholesaler list price to participating entities. These entities purchase products through wholesalers at the lower prime vendor price and the wholesalers charge the difference between their acquisition cost and the lower prime vendor price back to the Company. The Company accounts for prime vendor charge-backs by reducing accounts receivable in an amount equal to the Company’s estimate of charge-back claims attributable to a sale. The Company determines its estimate of the prime vendor charge-backs primarily based on historical experience regarding prime vendor charge-backs and current contract prices under the prime vendor programs. The Company considers prime vendor payments, levels of inventory in the distribution channel, and the Company’s claim processing time lag and adjusts the reduction to accounts receivable periodically throughout each quarter to reflect actual experience.

WIC rebates

The Company’s U.S. Nutritionals business participates on a competitive bidding basis in nutrition programs sponsored by states, tribal governments, the Commonwealth of Puerto Rico and the U.S. territories for WIC. Under these programs, the Company reimburses these entities for the difference between wholesaler list price and the contract price on eligible products. The Company accounts for WIC rebates by establishing an accrual in an amount equal to the Company’s estimate of WIC rebate claims attributable to a sale. The Company determines its estimate of the WIC rebate accrual primarily based on historical experience regarding WIC rebates and current contract prices under the WIC programs. The Company considers levels of inventory in the distribution channel, new WIC contracts, terminated WIC contracts, changes in existing WIC contracts, and WIC participation and adjusts the accrual periodically throughout each quarter to reflect actual experience.

Managed health care rebates and other contract discounts

The Company offers rebates and discounts to managed health care organizations in the U.S. which manage prescription drug programs and Medicare Advantage prescription drug plans covering the Medicare Part D drug benefit in addition to their commercial plans, as well as globally to other contract counterparties such as hospitals and group purchasing organizations. The Company accounts for managed health care rebates and other contract discounts by establishing an accrual in an amount equal to the Company’s estimate of managed health care rebates and other contract discounts attributable to a sale. The Company determines its estimate of the managed health care rebates and other contract discounts accrual primarily based on historical experience regarding these rebates and discounts and current contract prices. The Company considers the sales performance of products subject to managed health care rebates and other contract discounts and levels of inventory in the distribution channel and adjusts the accrual periodically throughout each quarter to reflect actual experience.

Medicaid rebates

The Company’s U.S. businesses participate in state government-managed Medicaid programs as well as certain other qualifying Federal and state government programs whereby discounts and rebates are provided to participating state and local government entities. Discounts and rebates provided through these latter programs are included in the Company’s Medicaid rebate accrual and are considered Medicaid rebates for the purposes of this discussion. The Company accounts for Medicaid rebates by establishing an accrual in an amount equal to the Company’s estimate of Medicaid rebate claims attributable to a sale. The Company determines its estimate of the Medicaid rebates accrual primarily based on historical experience regarding Medicaid rebates, as well as any expansion on a prospective basis of its participation in the non-mandatory aspects of the qualifying Federal and state government programs, legal interpretations of applicable laws related to Medicaid and qualifying Federal and state government programs, and any new information regarding changes in the Medicaid programs’ regulations and guidelines that would impact the amount of the rebates. The Company considers outstanding Medicaid claims, Medicaid payments, and levels of inventory in the distribution channel and adjusts the accrual periodically throughout each quarter to reflect actual experience.

Cash discounts

In the U.S. and certain other countries, the Company offers cash discounts, approximating 2% of the sales price, as an incentive for prompt payment. The Company accounts for cash discounts by reducing accounts receivable by the full amount of the discounts. The Company considers payment performance and adjusts the accrual to reflect actual experience.

Sales returns

The Company accounts for sales returns in accordance with SFAS No. 48, *Revenue Recognition When Right of Return Exists*, by establishing an accrual in an amount equal to the Company's estimate of sales recorded for which the related products are expected to be returned. In 2006, 2005 and 2004, the provision for sales returns was \$230 million, \$164 million and \$276 million, respectively, or 1% of gross sales for each of the three years.

For returns of established products, the Company determines its estimate of the sales return accrual primarily based on historical experience regarding sales returns, but also considers other factors that could impact sales returns. These factors include levels of inventory in the distribution channel, estimated shelf life, product recalls, product discontinuances, price changes of competitive products, introductions of generic products and introductions of competitive new products. The Company considers all of these factors and adjusts the accrual periodically throughout each quarter to reflect actual experience.

The Company considers the level of inventory in the distribution channel and determines whether it believes an adjustment to the sales return accrual is appropriate. The Company adjusts the sales return accrual based on historical experience, the Company's returned goods policy, the shelf life of the Company's products, and life cycle of the product levels of inventory in the distribution channel. The Company considers introductions of generic products and factors the impact into the sales returns calculation based on historical experience and the Company's returned goods policy.

In the event of a product recall or product discontinuance, the Company considers the reasons for and impact of such actions and adjusts the sales return accrual as appropriate, taking into account historical experience, estimated levels of inventory in the distribution channel and, for product discontinuances, estimates of continuing demand.

Sales returns accruals from new products are estimated and primarily based on the historical sales returns experience of similar products, such as those within the same line of product or those within the same or similar therapeutic category. In limited circumstances, where the new product is not an extension of an existing line of product or where the Company has no historical experience with products in a similar therapeutic category, such that the Company cannot reliably estimate expected returns of the new product, the Company defers recognition of revenue until the right of return no longer exists or until the Company has developed sufficient historical experience to estimate sales returns. The Company also considers the shelf life of new products and determines whether it believes an adjustment to the sales return accrual is appropriate. The shelf life in connection with new products tends to be shorter than the shelf life for more established products because the Company may still be developing an optimal manufacturing process for the new product that would lengthen its shelf life. In addition, higher launch quantities may have been manufactured in advance of the launch date to ensure sufficient supply exists to satisfy market demand. In those cases, the Company assesses the reduced shelf life, together with estimated levels of inventory in the distribution channel and projected demand, and determines whether it believes an adjustment to the sales return accrual is appropriate.

Other adjustments

In addition to the gross-to-net sales adjustments described above, the Company makes other gross-to-net sales adjustments. For example, the Company offers sales discounts, most significantly in its non-U.S. businesses, and also offers consumer coupons and rebates, most significantly in its U.S. Nutritionals and Pharmaceuticals business. In addition, in a number of countries outside the U.S., including major European countries, the Company provides rebates to government entities. The Company generally accounts for these other gross-to-net adjustments by establishing an accrual in an amount equal to the Company's estimate of the adjustments attributable to a sale. The Company generally determines its estimates of the accruals for these other gross-to-net sales adjustments primarily based on historical experience, performance on commitments to government entities and other relevant factors, including estimated levels of inventory in the distribution channel, and adjusts the accruals periodically throughout each quarter to reflect actual experience.

Use of information from external sources

The Company uses information from external sources to estimate its gross-to-net sales adjustments. The Company's estimates of inventory at the wholesalers and deferred revenue on consigned inventory are based on the projected prescription demand-based sales for its products and historical inventory experience, as well as the Company's analysis of third-party information, including written and oral information obtained from certain wholesalers with respect to their inventory levels and sell-through to customers and third-party market research data, and the Company's internal information. The inventory information received from wholesalers is a product of their record-keeping process and excludes inventory held by intermediaries to whom they sell, such as retailers and hospitals. The Company receives information from IMS, a supplier of market research to the pharmaceutical industry, which it uses to project the prescription demand-based sales for many of its U.S. Pharmaceuticals products. The Company has historically reported estimated total U.S. prescription growth and estimated therapeutic category share based on NPA data, which IMS made available to the public on a subscription basis, and a simple average of the estimated number of prescriptions in the retail and mail order channels. In the third quarter of 2005, the Company began disclosing estimated total U.S. prescription growth and estimated therapeutic category share based on both NPA and NGPS version 1.0 data. NGPS version 1.0 data was collected by IMS under a new, revised methodology and was released by IMS on a limited basis through a pilot program. IMS has announced that NGPS version 2.0 data is available to the public on a subscription basis starting in January 2007 and legacy NPA and NGPS version 1.0 will be discontinued. The Company believes that the NGPS data provided by IMS provides a superior estimate of prescription data for the Company's products in the retail and mail order channels. The Company has calculated the estimated total U.S. prescription growth and the estimated therapeutic category share based on NGPS data on a weighted average basis to reflect the fact that mail order prescriptions include a greater volume of product supplied compared with retail prescriptions. The Company believes that calculation of the estimated total U.S. prescription growth and the estimated therapeutic category share based on the NGPS data and the weighted average approach with respect to the retail and mail order channels provide a superior estimate of total prescription demand. The Company now uses this methodology for its internal demand forecasts. The Company also uses information from external sources to identify prescription trends, patient demand and average selling prices. The Company's estimates are subject to inherent limitations of estimates that rely on third-party information, as certain third-party information was itself in the form of estimates, and reflect other limitations including lags between the date as of which third-party information is generated and the date on which the Company receives third-party information.

Retirement Benefits

The Company's pension plans and postretirement benefit plans are accounted for using actuarial valuations required by SFAS No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. The Company considers accounting for retirement plans critical because management is required to make significant subjective judgments about a number of actuarial assumptions, including discount rates, salary growth, long-term return on plan assets, retirement, turnover, health care cost trend rates, and mortality rates. Depending on the assumptions and estimates used, the pension and postretirement benefit expense could vary within a range of outcomes and have a material effect on reported earnings. In addition, the assumptions can materially affect projected benefit obligations and future cash funding.

The Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, in the fiscal year ended December 31, 2006 and the adoption of this accounting pronouncement resulted in a \$1,064 million reduction of accumulated other comprehensive income in stockholders' equity, a \$767 million reduction in total assets and a \$297 million increase in total liabilities. The adoption of SFAS No. 158 did not impact the Company's results of operations or cash flows.

Plan Description

The Company and certain of its subsidiaries have defined benefit pension plans, defined contribution plans, and termination indemnity plans for regular full-time employees. The principal defined benefit pension plan is the Bristol-Myers Squibb Retirement Income Plan and the principal defined contribution plan is the Bristol-Myers Squibb Savings and Investment Program.

Approximately 80% of total Company defined benefit pension plan assets and liabilities are held in U.S. plans. The assets for the U.S. plans are held in a single trust with a common asset allocation. Unless specified otherwise, the references in this section are to total Company plans (i.e., U.S. plans together with international plans).

Benefits under the Company's defined benefit pension plans are based primarily on years of credited service and on participants' compensation. Assets under the Company's defined benefit plans consist primarily of equity and fixed-income securities. At December 31, 2006, the fair market value of plan assets for the Company's defined benefit plans increased to \$5,658 million from \$5,017 million at December 31, 2005. For the U.S. plans, assets were allocated 69% to equity securities (compared to 68% at the end of 2005), 23% to fixed income securities (compared to 25% at the end of 2005) and 8% to private equity and other investments (compared to 7% at the end of 2005). Bristol-Myers Squibb common stock represented less than 1% of assets for the U.S. plans at the end of 2006 and 2005.

The Company provides comprehensive medical and group life benefits for substantially all U.S. retirees who elect to participate in the Company's comprehensive medical and group life plans. The asset allocation for these postretirement plans is identical to the asset allocation described above for the U.S. defined benefit pension plans.

Accrual Accounting and Significant Assumptions

Consistent with the requirements of SFAS No. 87, the Company accounts for pension benefits using the accrual method, recognizing pension expense before the payment of benefits to retirees. The accrual method of accounting for pension benefits necessarily requires actuarial assumptions concerning future events that will determine the amount and timing of the benefit payments.

The Company's key assumptions used in calculating its cost of pension benefits are the discount rate, the rate of compensation increase, and the expected long-term rate of return on plan assets. The Company, in consultation with its actuaries, evaluates the key actuarial assumptions and other assumptions used in calculating its cost of pension benefits, such as retirement, turnover and mortality rates, based on expectations or actual experience, as appropriate, and determines such assumptions on December 31 of each year to calculate liability information as of that date and pension expense for the following year. Depending on the assumptions used, the pension expense could vary within a range of outcomes and have a material effect on reported earnings. In addition, the assumptions can materially affect projected benefit obligations and future cash funding. Actual results in any given year may differ from those estimated because of economic and other factors.

In determining the discount rate, the Company uses the yield on high quality corporate bonds that coincides with the cash flows of its plans' estimated payouts. The Citigroup Above Median yield curve is used in determining the discount rate for the U.S. plans. The assumed rate of compensation increase used by the Company for determining future pension obligations reflects an estimate of the change in actual future compensation levels due to general price levels, productivity, seniority and other factors.

In 2006, net pension expense for the Company's defined benefit pension plans included in earnings before minority interest and income taxes was \$332 million compared to \$392 million in 2005.

The U.S. plans' pension expense for 2006 was determined using a 5.75% assumed discount rate and a 3.56% assumed rate of compensation increase. The present value of benefit obligations at December 31, 2006 for the U.S. plans was determined using a 6.00% assumed discount rate and a 3.56% assumed rate of compensation increase. If the assumed discount rate used in determining the U.S. plans' pension expense for 2006 had been reduced by 0.25%, such expense would have increased by approximately \$18 million. If the assumed rate of compensation increase used in determining the U.S. plans' pension expense for 2006 had been reduced by 0.25%, such expense would have decreased by approximately \$9 million. If the assumed discount rate used in determining the accumulated benefit obligation at December 31, 2006 had been reduced by 0.25%, the accumulated benefit obligation would have increased by \$123 million.

The U.S. plans' pension expense for 2006 was determined using an 8.75% expected long-term rate of return on plan assets. If the expected long-term rate of return on plan assets used in determining the U.S. plans' pension expense for 2006 had been reduced by 1%, such expense would have increased by \$38 million.

Actual rates of return earned on U.S. plan assets for each of the last 10 years were as follows:

Year	Return	Year	Return
2006	14.9%	2001	(6.1)%
2005	9.8%	2000	3.5%
2004	12.6%	1999	18.2%
2003	25.0%	1998	13.3%
2002	(13.4)%	1997	22.2%

At December 31, 2006, the Company increased its assumed discount rate for U.S. plans from 5.75% to 6.00% and maintained its assumed rate of compensation increase at 3.56%. Compensation is assumed to increase on a scale with different rates for different ages. The 3.56% rate disclosed at December 31, 2006 is the single rate, which, if used at each age, would produce the same present value of benefit obligations.

The Company maintained the expected rate of return on U.S. plan assets at 8.75% for 2007.

The Company expects that the net pension expense for its defined benefit pension plans included in earnings before minority interest and income taxes will be approximately \$25 million lower in 2007 than the \$332 million in 2006, reflecting primarily the positive delayed impact of the favorable 2004-2006 investment returns.

The Company has used the same assumed discount rates and expected long-term rates of return on plan assets in calculating its cost of pension benefits and its cost of other postretirement benefits for U.S. plans except in the case of the discount rates at December 31, 2006 and 2005. Rates of 6.00% and 5.75%, respectively, were used for pension benefits versus 5.75% and 5.50%, respectively, for other postretirement benefits to reflect the shorter duration of the other postretirement liabilities at December 31, 2006 and 2005, respectively.

U.S. health care costs for the retiree population are assumed to increase 10.0% in 2007 and then trend down to an expected increase of 4.5% per year by 2018. If actual costs are higher than those assumed, this will likely put significant upward pressure on the Company's expense for retiree health care.

The effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 are reflected in 2006 net periodic postretirement benefit cost (a reduction of \$11 million) and accumulated postretirement benefit obligation at January 1, 2006 (a reduction of \$94 million).

Recognition of Actuarial Gains and Losses

In 2006, SFAS No. 158 requires the recognition of actuarial gains and losses as a component of stockholders' equity in accumulated other comprehensive income while SFAS No. 87 provides for delayed recognition in years prior to 2006. These amounts arise from changes in the estimated plan benefit obligations due to changes in the assumed discount rate, differences between the actual and expected returns on plan assets, and other assumption changes. The net actuarial gain or loss, determined based on the market-related value of plan assets (which differs from fair market value and is a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years), be amortized in pension income or expense for the year to the extent that such unrecognized net actuarial loss or gain exceeds 10% of the greater of the projected benefit obligation or the market-related value of plan assets at the beginning of the year. These net gains and losses are recognized as pension income or expense prospectively over a period that approximates the average remaining service period of active employees expected to receive benefits under the plans (approximately 10 years) to the extent that they are not offset by losses and gains in subsequent years.

The unrecognized net actuarial loss reflects in large part the steady reduction of the weighted-average discount rate over the years. Unless offset by future unrecognized gains from higher discount rates or higher than expected returns on plan assets, amortization of the unrecognized loss is expected to increase pension expense by \$133 million in 2007 and by progressively lower amounts for each of the following nine years.

Plan Funding

The Company's funding policy for defined benefit plans is to contribute amounts to provide for current service and to fund past service liability. The Company contributed \$325 million and \$423 million to the defined benefit plans in 2006 and 2005, respectively.

For discussions on retirement benefits, see Note 20 "Pension and Other Postretirement Benefit Plans."

Acquired In-Process Research and Development

The fair value of in-process research and development acquired in a business combination is determined by independent appraisal based on the present value of each research project's projected cash flows. An income approach is utilized that is consistent with guidance in the practice aid issued by the American Institute of Certified Public Accountants, *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices and Pharmaceutical Industries*. Future cash flows are predominately based on the net income forecast of each project, consistent with historical pricing, margins, and expense levels of similar products. Revenues are estimated based on relevant market size and growth factors, expected industry trends, individual project life cycles, and the life of each research project's underlying patent. In determining the fair value of each research project, expected revenues are first adjusted for technical risk of completion. The resulting cash flows are then discounted at a rate approximating the Company's weighted average cost of capital. Other acquired in-process research and development is expensed as incurred when the underlying product has not received regulatory approval and does not have any future alternative use. In addition, costs that are nonrefundable, related to the acquisition or licensing of products that have not yet received regulatory approval to be marketed and that have no alternative future use, are charged to earnings as incurred.

For discussions on acquired in-process research and development, see Note 1 "Accounting Policies—Acquired In-Process Research and Development."

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company periodically evaluates whether current facts or circumstances indicate that the carrying value of its depreciable assets to be held and used may not be recoverable. If such circumstances are determined to exist, an estimate of undiscounted future cash flows produced by the long-lived asset, or the appropriate grouping of assets, is compared to the carrying value to determine whether impairment exists. If an asset is determined to be impaired, the loss is measured based on the difference between the asset's fair value and its carrying value. An estimate of the asset's fair value is based on quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including a discounted value of estimated future cash flows. The Company reports an asset to be disposed of at the lower of its carrying value or its estimated net realizable value.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is tested at least annually for impairment using a two-step process. The first step is to identify a potential impairment, and the second step measures the amount of the impairment loss, if any. Goodwill is deemed to be impaired if the carrying amount of a reporting unit's goodwill exceeds its estimated fair value. SFAS No. 142 requires that indefinite-lived intangible assets be tested for impairment using a one-step process, which consists of a comparison of the fair value to the carrying value of the intangible asset. Such intangible assets are deemed to be impaired if their net book value exceeds their estimated fair value. All other intangible assets are evaluated for impairment in accordance with SFAS No. 144 as described above.

The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's judgment. Any changes in key assumptions about the Company's businesses and their prospects, or changes in market conditions, could result in an impairment charge.

For discussions on impairment of long-lived assets, see Note 1 "Accounting Policies—Impairment of Long-Lived Assets" and "—Goodwill and Other Intangible Assets."

Equity Investments

The Company reviews its equity investments for impairment based on its determination of whether the decline in market value of the investment below the Company's carrying value is other than temporary. In making this determination, the Company considers APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* and related interpretations, which set forth factors to be evaluated in determining whether a loss in value should be recognized, including the Company's ability to hold its investment, the market price and market price fluctuations of the investment's publicly traded shares and inability of the investee to sustain an earnings capacity, which would justify the carrying amount of the investment. The Company's investment in ImClone is subject to this accounting. For a discussion of the Company's investment in ImClone, see Note 2 "Alliances and Investments."

For discussions on equity investments, see Note 1 "Accounting Policies—Investments" and Note 2 "Alliances and Investments."

Restructuring

To streamline operations and rationalize manufacturing facilities, the Company has periodically recorded restructuring charges. As a result, the Company has made estimates and judgments regarding its future plans, including future termination benefits and other exit costs to be incurred when the restructuring actions take place. Actual results could vary from these estimates. Adjustments of \$14 million, \$1 million and \$8 million were recorded in 2006, 2005 and 2004, respectively, and reflect changes in estimates for restructuring actions taken in prior periods.

For discussions on restructuring, see Note 1 "Accounting Policies—Restructuring" and Note 3 "Restructuring and Other Items."

Contingencies

In the normal course of business, the Company is subject to contingencies, such as legal proceedings and claims arising out of its business, that cover a wide range of matters, including, among others, government investigations, shareholder lawsuits, product and environmental liability, and tax matters. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company records accruals for such contingencies when it is probable that a liability will be incurred and the amount of the loss can be reasonably estimated.

For discussions on contingencies, see Note 1 "Accounting Policies—Income Taxes and Contingencies;" Note 8 "Income Taxes;" and Note 21 "Legal Proceedings and Contingencies."

Income Taxes

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. The assessment of whether or not a valuation allowance is required often requires significant judgment including the long-range forecast of future taxable income and the evaluation of tax planning initiatives. Adjustments to the deferred tax valuation allowances are made to earnings in the period when such assessments are made. As of December 31, 2006 and 2005, the Company had net deferred tax assets of \$3,154 million and \$2,380 million, respectively, net of valuation allowances of \$625 million and \$559 million, respectively. The increase in net deferred tax assets in 2006 primarily resulted from the adoption of SFAS No. 158, see Note 8 "Income Taxes" and Note 20 "Pension and Other Postretirement Benefit Plans."

The Company has recorded significant deferred tax assets related to U.S. foreign tax credit carryforwards of approximately \$1,071 million and U.S. research tax credit carryforwards of approximately \$259 million, which expire in varying amounts beginning in 2012. Realization of the foreign tax credit and research tax credit carryforwards is dependent on generating sufficient domestic taxable income prior to their expiration. Although realization is not assured, management believes it is more likely than not that these deferred tax assets will be realized. The Company anticipates increasing its level of domestic profitability over time by undertaking actions such as increasing its biologics manufacturing capacity in the U.S. and implementing tax planning strategies. While increasing domestic profitability will likely cause the Company's effective tax rate to increase, it will also further enhance the Company's ability to utilize its foreign tax credit and research tax credit carryforwards. The amount of foreign tax credit and research tax credit carryforwards considered realizable, however, could be reduced in the near term if Plavix is subject to either renewed or additional generic competition. If such events occur, the Company may need to record significant valuation allowances against these U.S. Federal deferred tax assets. For a discussion of Plavix related matters, see Note 21 "Legal Proceedings and Contingencies."

The Company conducts business in various countries throughout the world and is subject to tax in numerous jurisdictions. As a result of its business activities, the Company files a significant number of tax returns that are subject to examination by various Federal, state, and local tax authorities. Tax examinations are often complex as tax authorities may disagree with the treatment of items reported by the Company and may require several years to resolve. The Company establishes liabilities for possible assessments by tax authorities resulting from known tax exposures, including, but not limited to, transfer pricing matters, tax credits, and deductibility of certain expenses. Such liabilities represent a reasonable provision for taxes ultimately expected to be paid, and may need to be adjusted over time as more information becomes known.

As of December 31, 2006, the Company had approximately \$11.3 billion of undistributed earnings of foreign subsidiaries for which taxes have not been provided as the Company has invested or expects to invest these undistributed earnings permanently offshore. If in the future these earnings are repatriated to the U.S., or if the Company determines such earnings will be remitted in the foreseeable future, additional tax provisions would be required. Due to complexities in the tax laws and the assumptions that would have to be made, it is not practicable to estimate the amounts of income taxes that would have to be provided.

For discussions on income taxes, see Note 1 "Accounting Policies—Income Taxes" and Note 8 "Income Taxes."

Stock-Based Compensation Expense

The Company adopted SFAS No. 123(R), *Share-Based Payment*, which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors based on estimated fair values. The Company uses the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, and has elected the alternative method as provided in FSP No. 123(R)-3 in determining the Company's pool of excess tax benefits. The Company's consolidated financial statements for the year ended December 31, 2006 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Stock-based compensation expense recognized under SFAS No. 123(R) for the year ended December 31, 2006 was \$112 million (\$73 million, net of tax) or \$0.04 per share, with a corresponding amount recorded in additional paid-in capital within stockholders' equity. Comparatively, on a pro forma basis, stock-based compensation expense of \$31 million and \$30 million (\$20 million and \$19 million, net of tax), respectively, was recognized for the years ended December 31, 2005 and 2004, respectively, under APB No. 25. Additionally, \$10 million related to performance awards was reclassified from liabilities to stockholders' equity in connection with the adoption of SFAS No. 123(R).

The Company estimates the fair value of stock-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statement of earnings. Prior to the adoption of SFAS No. 123(R), the Company accounted for stock-based

awards to employees and directors using the intrinsic value method related to stock options in accordance with APB No. 25 as allowed under SFAS No. 123, *Accounting for Stock-Based Compensation*. Under the intrinsic value method, no stock-based compensation expense had been recognized in the Company's consolidated statement of earnings because the exercise price of the Company's stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company's consolidated statement of earnings for the year ended December 31, 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123(R) and compensation expense for the stock-based payment awards granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

In conjunction with the adoption of SFAS No. 123(R), the Company changed its method of attributing the value of stock-based compensation expense from the accelerated multiple-option approach to the straight-line single option method. Compensation expense for all stock-based payment awards granted prior to 2006 will continue to be recognized using the accelerated multiple-option approach while compensation expense for all stock-based payment awards, with a service condition only, granted on or subsequent to January 1, 2006 is recognized using the straight-line single-option method. Stock-based payment awards granted on or subsequent to January 1, 2006, with both a service and market condition will be recognized using the accelerated multiple-option approach as required under SFAS No. 123(R).

Prior to 2006, the Company applied APB Opinion No. 25, and did not recognize compensation expense for stock options granted under the plans as the exercise price of the option on the date of grant is equal to the fair market value as of that date. However, for grants of restricted stock, the Company recognized compensation expense on a straight-line basis over the period that the restrictions expire.

The fair value of the options granted during 2006, 2005 and 2004 was estimated as \$4.74 per common share, \$5.49 per common share and \$5.91 per common share, respectively, on the date of grant using the Black-Scholes option-pricing model. The assumptions used in the Black-Scholes option-pricing model were as follows:

	2006	2005	2004
Expected volatility	26.7%	29.4%	30.0%
Risk-free interest rate	4.6%	4.4%	3.5%
Dividend yield	4.8%	4.6%	4.4%
Expected life	6.3 yrs	7.0 yrs	7.0 yrs

The Company determines fair value of certain stock-based payment awards on the date of grant using an option-pricing model. This model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

With respect to the accounting treatment of retirement eligibility provisions of employee stock-based compensation awards, the Company has historically followed the nominal vesting period approach. Upon the adoption of SFAS No. 123(R), the Company follows the non-substantive vesting period approach and recognizes compensation cost over a one-year period for awards granted to retirement eligible employees, or over the period from the grant date to the date retirement eligibility is achieved if more than one year, but less than the vesting period. The impact of applying the non-substantive vesting period approach is not material to the Company's consolidated financial statements.

As stock-based compensation expense recognized in the consolidated statement of earnings for the year ended December 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. The Company estimates forfeitures at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS No. 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

Special Note Regarding Forward-Looking Statements

This annual report and other written and oral statements the Company makes from time to time contain certain “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify these forward-looking statements by the fact they use words such as “should”, “expect”, “anticipate”, “estimate”, “target”, “may”, “project”, “guidance”, “intend”, “plan”, “believe” and other words and terms of similar meaning and expression in connection with any discussion of future operating or financial performance. One can also identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. Such forward-looking statements are based on current expectations and involve inherent risks and uncertainties, including factors that could delay, divert or change any of them, and could cause actual outcomes to differ materially from current expectations. These statements are likely to relate to, among other things, the Company’s goals, plans and projections regarding its financial position, results of operations, cash flows, market position, product development, product approvals, sales efforts, expenses, performance or results of current and anticipated products and the outcome of contingencies such as legal proceedings, and financial results, which are based on current expectations that involve inherent risks and uncertainties, including internal or external factors that could delay, divert or change any of them in the next several years. The Company has included important factors in the cautionary statements included in this annual report that the Company believes could cause actual results to differ materially from any forward-looking statement.

Although the Company believes it has been prudent in its plans and assumptions, no assurance can be given that any goal or plan set forth in forward-looking statements can be achieved and readers are cautioned not to place undue reliance on such statements, which speak only as of the date made. The Company undertakes no obligation to release publicly any revisions to forward-looking statements as a result of new information, future events or otherwise.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk due to changes in currency exchange rates and interest rates. To reduce that risk, the Company enters into certain derivative financial instruments, when available on a cost-effective basis, to hedge its underlying economic exposure. These instruments are managed on a consolidated basis to efficiently net exposures and thus take advantage of any natural offsets. Derivative financial instruments are not used for speculative purposes. Gains and losses on hedging transactions are offset by gains and losses on the underlying exposures being hedged. Any ineffective portion of hedges is reported in earnings as it occurs.

The Company's primary net foreign currency translation exposures are the Euro, Japanese yen, Mexican peso, Chinese renminbi and Canadian dollar.

The Company utilizes foreign currency contracts to hedge anticipated transactions, primarily intercompany transactions, on certain foreign currencies and designates these derivative instruments as foreign currency cash flow hedges when appropriate.

The fair value of all foreign exchange forward contracts is based on year-end currency rates. The fair value of foreign exchange forward contracts should be viewed in relation to the fair value of the underlying hedged transactions and the overall reduction in exposure to adverse fluctuations in foreign currency exchange rates. The Company's outstanding foreign exchange forward contracts as of December 31, 2006 were as follows:

Dollars in Millions, Except Currency Rates	Weighted-Average Strike Price	Notional Amount	Fair Value Asset/(Liability)	Maturity
Foreign Exchange Forwards:				
Australian Dollar	0.76	\$ 102	\$ (2)	2007/2008
British Pound	1.87	36	(2)	2007
Canadian Dollar	1.15	185	2	2007/2008
Euro	1.27	922	(42)	2007/2008
Japanese Yen	107.8	209	12	2007/2008
Mexican Peso	10.94	55	—	2007
Swedish Krona	6.89	34	(1)	2007/2008
Swiss Franc	1.18	42	—	2007/2008
Total Contracts		\$ 1,585	\$ (33)	

At December 31, 2006, the Company held foreign exchange forward contracts with maturity dates from 2007 to 2008. At December 31, 2006, the Company did not hold any foreign exchange option contracts. The notional amounts and fair values of the foreign exchange forward contract maturity dates were as follows:

Dollars in Millions	Year of Maturity	Notional Amount	Fair Value
	2007	\$ 1,173	\$ (35)
	2008	412	2

At December 31, 2006, the fair value of the Company's foreign exchange forward contracts was a net liability of \$33 million, of which \$18 million was recorded as a non-current asset and \$51 million was recorded as a current liability. The Company estimates that a 10% appreciation or depreciation in the underlying currencies being hedged from their levels against the dollar as of December 31, 2006, with all other variables held constant, would decrease or increase, respectively, by \$159 million, the fair value of foreign exchange forward contracts held at December 31, 2006.

The Company is obligated to settle foreign exchange forward contracts based on the specified contract rates. As of December 31, 2006, the balance of deferred net after-tax losses of foreign exchange forward contracts included in accumulated other comprehensive income was \$22 million, of which a net after-tax loss of \$25 million is estimated to be reclassified into earnings within the next 12 months.

At December 31, 2005, the Company held foreign exchange forward contracts with an aggregate notional amount of \$2,296 million. The fair value of the foreign exchange forward contracts was a net asset of \$53 million, of which \$94 million was recorded as a non-current asset and \$41 million was recorded as a current liability. These contracts primarily related to exposures in Euro, Canadian dollar and Australian dollar. The Company estimates that a 10% appreciation or depreciation in the underlying currencies being hedged from their levels against the dollar as of December 31, 2005, with all other variables held constant, would decrease or increase, respectively, by \$230 million, the fair value of foreign exchange forward contracts held at December 31, 2005.

For the years ended December 31, 2006, 2005 and 2004, the impact of hedge ineffectiveness on earnings was not significant. Additionally, for the years ended December 31, 2006, 2005 and 2004, the impact of discontinued hedges was a loss of \$10 million, a gain of \$2 million and a gain of \$1 million, respectively. Furthermore, the Company uses foreign exchange forward contracts to offset its exposure to certain currency assets and liabilities. These foreign exchange forward contracts are not designated as hedges and, therefore, changes in the fair value of these derivatives are recognized in earnings as they occur. In 2006, 2005 and 2004, the amounts recognized in earnings related to foreign exchange forward contracts that did not qualify for hedge accounting treatment were not significant.

The Company also uses foreign exchange forward contracts to hedge foreign currency denominated monetary assets and liabilities. The primary objective of these foreign exchange forward contracts is to protect the U.S. dollar value of foreign currency denominated monetary assets and liabilities from the effects of volatility in foreign exchange rates that might occur prior to their receipt or settlement in U.S. dollars. These foreign currency denominated monetary assets and liabilities are primarily denominated in Euro. The foreign exchange forward contracts are not designated as hedges and are marked to market through other income/expense. The notional and fair value amounts of purchased foreign exchange forward contracts were \$24 million and a \$1 million asset, respectively, at December 31, 2006, and were \$142 million and a \$2 million liability, respectively, at December 31, 2005. The notional and fair value amounts of sold foreign exchange forward contracts were \$22 million and a \$1 million liability, respectively, at December 31, 2006, and were \$47 million and a \$1 million asset, respectively, at December 31, 2005.

In addition to the foreign exchange forward contracts noted above, the Company uses non U.S. dollar borrowings and, to a lesser extent, foreign exchange forward contracts, to hedge the foreign currency exposures of the Company's net investment in certain foreign affiliates. These non U.S. dollar borrowings and foreign exchange forward contracts are designated as hedges of net investments. The effective portion of foreign exchange gains or losses on these hedges is recorded as part of the foreign currency translation component of other comprehensive income. At December 31, 2006 and 2005, \$17 million in after-tax losses and \$12 million in after-tax gains, respectively, were recorded in the foreign currency translation component of accumulated other comprehensive income.

The Company uses derivative instruments as part of its interest rate risk management strategy. The derivative instruments used are comprised principally of fixed to floating rate interest rate swaps, which are subject to fair-value hedge accounting treatment. In November 2006, in connection with the funding of the retirement of the 2011 fixed rate debt, the Company executed several fixed to floating interest rate swaps to convert \$1.3 billion and €1 billion Euro (\$1.3 billion) of the Company's newly issued fixed rate debt to be paid in 2016, 2021, and 2036 to variable rate debt. During 2004, the Company executed several fixed to floating interest rate swaps to convert \$700 million of the Company's fixed rate debt to be paid in 2023 and 2026 to variable rate debt. The total notional amount of outstanding interest rate swaps were \$2.6 billion and €1 billion Euro (\$1.3 billion) as of December 31, 2006 and \$3.4 billion as of December 31, 2005, respectively. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Company recognized a net increase in interest expense of \$18 million in 2006, and a net reduction in interest expense of \$54 million and \$151 million in 2005 and 2004, respectively, from the impact of interest rate swaps.

SFAS No. 133 requires the revaluation, at fair value, of the swap contracts as well as the underlying debt being hedged. As such, the swap contracts and the underlying debt have been revalued resulting in an increase in non-current assets of \$7 million, and current liabilities of \$57 million, and a reduction in long-term debt of \$50 million at December 31, 2006; and an increase in non-current assets of \$21 million, and current liabilities of \$51 million, and a reduction in long-term debt of \$30 million at December 31, 2005. Swap contracts are generally held to maturity and are intended to create an appropriate balance of fixed and floating rate debt for the Company. Swap contracts that qualify as fair value hedges that are terminated prior to their maturity dates are reported as part of the carrying value of the underlying debt and are amortized to earnings over the remaining life of the debt. Swap contracts that qualify as cash flow hedges that are terminated are reported in accumulated other comprehensive income and amortized to earnings over the remaining life of the debt. Interest rate swaps outstanding as of December 31, 2006 and terminated interest rate swaps for 2006 and 2005 were as follows:

Interest Rate Contracts	Notional Amount of Underlying Debt	Variable Rate Received	Year of Transaction	Maturity	Fair Value
Dollars in Millions					
Swaps associated with:					
4.00% Notes due 2008	\$ 400	1 month U.S. \$ LIBOR +0.35%	2003	2008	\$ (9)
5.25% Notes due 2013	600	1 month U.S. \$ LIBOR +0.42%	2003	2013	(9)
4.375% €500 Million EUR Notes due 2016	656	3 month EUR € EURIBOR +0.40%	2006	2016	(12)
4.625% €500 Million EUR Notes due 2021	656	3 month EUR € EURIBOR +0.56%	2006	2021	(16)
7.15% Notes due 2023	350	1 month U.S. \$ LIBOR +1.66%	2004	2023	7
5.875% Notes due 2036	1,250	1 month U.S. \$ LIBOR +0.62%	2006	2036	(11)
	<u>\$ 3,912</u>				<u>\$ (50)</u>

Terminated Swap Contracts

Interest Rate Contracts	Year of Termination	Notional Amount of Underlying Debt	Total Pre-Tax Deferred Gain/(Loss)	2006 Pre-Tax Income/(Expense) Recognized	2005 Pre-Tax Income/(Expense) Recognized
Dollars in Millions					
Interest rate swap lock associated with 5.75% Notes due 2011 ⁽¹⁾					
	2001	\$2,500	\$ (58)	\$ (37)	\$ (5)
Interest Rate Swap Lock associated with 4.75% Notes due 2006					
	2001	2,000	(48)	—	(15)
Swaps associated with 4.75% Notes due 2006 ⁽¹⁾					
	2005	2,000	(13)	—	(13)
Swaps associated with 5.75% Notes due 2011 ⁽¹⁾					
	2005	500	(23)	(21)	(2)
Swaps associated with 6.8% Notes due 2026					
	2005	350	39	1	—
Swaps associated with 5.75% Notes due 2011 ⁽¹⁾					
	2006	2,000	(62)	(62)	—
			<u>\$(165)</u>	<u>\$ (119)</u>	<u>\$ (35)</u>

(1) The underlying 2011 and 2006 Notes were extinguished in 2006 and 2005, respectively.

At December 31, 2006, the Company held interest rate swap contracts with a notional value of \$2.6 billion and €1.0 billion Euro (\$1.3 billion) and a fair value of a net liability of \$50 million.

It is estimated that an increase or decrease of 50 basis points in short-term or long-term interest rates would not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

The Company had \$7,248 million and \$8,364 million of long-term debt outstanding at December 31, 2006 and 2005, respectively. For additional information, see Note 14 "Short-Term Borrowings and Long-Term Debt" and see Note 17 "Financial Instruments."

The Company maintains cash, cash equivalents and marketable securities with various financial institutions, in order to limit exposure to any one financial institution. These financial institutions are headquartered primarily in North America and Europe.

CONSOLIDATED STATEMENTS OF EARNINGS

Dollars and Shares in Millions, Except Per Share Data

	Year Ended December 31,		
	2006	2005	2004
EARNINGS			
Net Sales	\$ 17,914	\$ 19,207	\$ 19,380
Costs of products sold	5,956	5,928	5,989
Marketing, selling and administrative	4,919	5,106	5,016
Advertising and product promotion	1,351	1,476	1,411
Research and development	3,067	2,746	2,500
Acquired in-process research and development	—	—	63
Provision for restructuring, net	59	32	104
Litigation charges, net	302	269	420
Gain on sale of product asset and businesses	(200)	(569)	(320)
Equity in net income of affiliates	(474)	(334)	(273)
Other expense, net	299	37	52
Total expenses	15,279	14,691	14,962
Earnings from Continuing Operations Before			
Minority Interest and Income Taxes	2,635	4,516	4,418
Provision for income taxes	610	932	1,519
Minority interest, net of taxes	440	592	521
Earnings from Continuing Operations	1,585	2,992	2,378
Discontinued Operations			
Earnings/(loss), net of taxes	—	(5)	10
Gain on disposal, net of taxes	—	13	—
	—	8	10
Net Earnings	\$ 1,585	\$ 3,000	\$ 2,388
Earnings per Common Share			
Basic:			
Earnings from Continuing Operations	\$ 0.81	\$ 1.53	\$ 1.23
Discontinued Operations			
Loss, net of taxes	—	—	—
Gain on disposal, net of taxes	—	—	—
Net Earnings per Common Share	\$ 0.81	\$ 1.53	\$ 1.23
Diluted:			
Earnings from Continuing Operations	\$ 0.81	\$ 1.52	\$ 1.21
Discontinued Operations			
Loss, net of taxes	—	—	—
Gain on disposal, net of taxes	—	—	—
Net Earnings per Common Share	\$ 0.81	\$ 1.52	\$ 1.21
Average Common Shares Outstanding			
Basic	1,960	1,952	1,942
Diluted	1,963	1,983	1,976
Dividends declared per common share	\$ 1.12	\$ 1.12	\$ 1.12

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME AND RETAINED EARNINGS

Dollars in Millions

	Year Ended December 31,		
	2006	2005	2004
COMPREHENSIVE INCOME			
Net Earnings	\$ 1,585	\$ 3,000	\$ 2,388
Other Comprehensive Income/(Loss):			
Foreign currency translation, no tax effect in 2006, net of tax liability of \$3 in 2005 and tax benefit of \$48 in 2004	129	(270)	208
Deferred gains/(losses) on derivatives qualifying as hedges, net of tax benefit of \$10 in 2006, net of tax liability of \$122 in 2005 and \$1 in 2004	(39)	325	(51)
Minimum pension liability adjustment, net of tax liability of \$44 in 2006 and net of tax benefit of \$4 in 2005 and \$42 in 2004	82	(6)	(93)
Available for sale securities, net of tax liability of \$6 in 2006, net of tax benefit of \$12 in 2005 and no tax effect in 2004	12	(22)	(1)
Total Other Comprehensive Income/(Loss)	184	27	63
Comprehensive Income	\$ 1,769	\$ 3,027	\$ 2,451
RETAINED EARNINGS			
Retained Earnings, January 1	\$ 20,464	\$ 19,651	\$ 19,439
Net earnings	1,585	3,000	2,388
Cash dividends declared	(2,204)	(2,187)	(2,176)
Retained Earnings, December 31	\$ 19,845	\$ 20,464	\$ 19,651

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEETS

Dollars in Millions Except Per Share Data

	December 31,	
	2006	2005
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,018	\$ 3,050
Marketable securities	1,995	2,749
Receivables, net of allowances of \$150 and \$207	3,247	3,378
Inventories, net	2,079	2,060
Deferred income taxes, net of valuation allowances	649	776
Prepaid expenses	314	270
Total Current Assets	10,302	12,283
Property, plant and equipment, net	5,673	5,693
Goodwill	4,829	4,823
Other intangible assets, net	1,852	1,921
Deferred income taxes, net of valuation allowances	2,577	1,808
Prepaid pension	—	1,324
Other assets	342	286
Total Assets	\$ 25,575	\$ 28,138
LIABILITIES		
Current Liabilities:		
Short-term borrowings	\$ 187	\$ 231
Accounts payable	1,239	1,579
Accrued expenses	2,332	2,321
Accrued rebates and returns	823	1,056
Deferred income	411	125
U.S. and foreign income taxes payable	444	538
Dividends payable	552	547
Accrued litigation liabilities	508	493
Total Current Liabilities	6,496	6,890
Pension and other postretirement liabilities	942	804
Deferred income	354	241
Other liabilities	544	631
Long-term debt	7,248	8,364
Total Liabilities	15,584	16,930
Commitments and contingencies (Note 21)		
STOCKHOLDERS' EQUITY		
Preferred stock, \$2 convertible series: Authorized 10 million shares; issued and outstanding 6,001 in 2006 and 6,540 in 2005, liquidation value of \$50 per share	—	—
Common stock, par value of \$.10 per share: Authorized 4.5 billion shares; 2.2 billion issued in both 2006 and 2005	220	220
Capital in excess of par value of stock	2,498	2,457
Accumulated other comprehensive loss	(1,645)	(765)
Retained earnings	19,845	20,464
Total Stockholders' Equity	20,918	22,376
Less cost of treasury stock — 238 million common shares in 2006 and 248 million in 2005	(10,927)	(11,168)
Total Stockholders' Equity	9,991	11,208
Total Liabilities and Stockholders' Equity	\$ 25,575	\$ 28,138

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in Millions

	Year Ended December 31,		
	2006	2005	2004
Cash Flows From Operating Activities:			
Net earnings	\$ 1,585	\$ 3,000	\$ 2,388
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	564	577	593
Amortization	363	352	316
Deferred income tax (benefits)/expense	(236)	(812)	278
Litigation settlement expense, net of recoveries	302	269	420
Stock-based compensation expense	112	—	—
Provision for restructuring	59	32	104
Gain on sale of product asset and businesses	(207)	(632)	(320)
Deferred income recognized	—	(143)	—
Acquired in-process research and development	—	—	63
Impairment charges and asset write-offs	120	42	—
Loss on disposal of property, plant and equipment and investment in other companies	26	36	18
Deferred expenses on extinguishment of long-term debt	62	—	—
(Under)/over distribution of earnings from affiliates	(35)	50	7
Unfunded pension expense	8	(31)	(91)
Changes in operating assets and liabilities:			
Receivables	210	539	(556)
Inventories	78	(370)	(133)
Prepaid expenses and other assets	(43)	38	18
Litigation settlement payments, net of insurance recoveries	(272)	11	(500)
Accounts payable, accrued expenses and deferred income	(460)	(378)	248
Product liability	(50)	(48)	38
U.S. and foreign income taxes payable	(91)	(534)	228
Other liabilities	(12)	(162)	57
Net Cash Provided by Operating Activities	2,083	1,836	3,176
Cash Flows From Investing Activities:			
Purchases of and proceeds from marketable securities, net	762	1,043	(779)
Additions to property, plant and equipment and capitalized software	(785)	(738)	(676)
Proceeds from disposal of property, plant and equipment and investment in other companies	10	73	35
Proceeds from sale of product assets and businesses	226	843	364
Proceeds from sale and leaseback of properties	281	—	—
Upfront and milestone payments	(280)	—	(250)
Purchase of Acordis Speciality Fibres	—	—	(150)
Purchases of trademarks, patents, licenses & other businesses and investments in other companies	(8)	(30)	(137)
Divestiture and acquisition costs	—	—	(29)
Net Cash Provided by/(Used in) Investing Activities	206	1,191	(1,622)
Cash Flows From Financing Activities:			
Short-term borrowings/(repayments)	30	(1,625)	1,558
Long-term debt borrowings	2,506	2,510	15
Long-term debt repayments	(3,700)	(2,502)	(3)
Charges on extinguishment of long-term debt	(158)	—	—
Issuances of common stock under stock plans and excess tax benefits from share-based payment arrangements	170	166	141
Dividends paid	(2,199)	(2,186)	(2,174)
Net Cash Used in Financing Activities	(3,351)	(3,637)	(463)
Effect of Exchange Rates on Cash and Cash Equivalents	30	(20)	40
(Decrease)/Increase in Cash and Cash Equivalents	(1,032)	(630)	1,131
Cash and Cash Equivalents at Beginning of Period	3,050	3,680	2,549
Cash and Cash Equivalents at End of Period	\$ 2,018	\$ 3,050	\$ 3,680

The accompanying notes are an integral part of these financial statements.

Note 1 Accounting Policies

Basis of Consolidation

The consolidated financial statements include the accounts of Bristol-Myers Squibb Company (BMS, the Company or Bristol-Myers Squibb) and all of its controlled majority-owned subsidiaries. All intercompany balances and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation.

Use of Estimates

The preparation of financial statements in conformity with United States (U.S.) generally accepted accounting principles (GAAP) requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant assumptions are employed in estimates used in determining values of intangible assets, restructuring charges and accruals, sales rebate and return accruals, legal contingencies and tax assets and tax liabilities, as well as in estimates used in applying the revenue recognition policy and accounting for stock-based compensation costs and retirement and postretirement benefits (including the actuarial assumptions). Actual results may or may not differ from estimated results.

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, as amended by SAB No. 104, *Revenue Recognition*, when substantially all the risks and rewards of ownership have transferred to the customer. Generally, revenue is recognized at time of shipment. However, in the case of certain sales made by the Nutritionals and Other Health Care segments and certain non-U.S. businesses within the Pharmaceuticals segment, revenue is recognized on the date of receipt by the purchaser. Revenues are reduced at the time of recognition to reflect expected returns that are estimated based on historical experience and business trends. Additionally, provisions are made at the time of revenue recognition for discounts, rebates and estimated sales allowances based on historical experience updated for changes in facts and circumstances, as appropriate. Such provisions are recorded as a reduction of revenue.

In the case of sales made to wholesalers (1) as a result of incentives, (2) in excess of the wholesaler's ordinary course of business inventory level, (3) at a time when there was an understanding, agreement, course of dealing or consistent business practice that the Company would extend incentives based on levels of excess inventory in connection with future purchases, and (4) at a time when such incentives would cover substantially all, and vary directly with, the wholesaler's cost of carrying inventory in excess of the wholesaler's ordinary course of business inventory level, substantially all the risks and rewards of ownership did not transfer upon shipment, and accordingly, such sales were accounted for using the consignment model. The determination of when, if at all, sales to a wholesaler meet the foregoing criteria involves evaluation of a variety of factors and a number of complex judgments. Under the consignment model, the Company does not recognize revenue upon shipment of product. Rather, upon shipment of product the Company invoices the wholesaler, records deferred revenue at gross invoice sales price, and classifies the inventory held by the wholesalers as consignment inventory at the Company's cost of such inventory. The Company recognizes revenue when the consignment inventory is no longer subject to incentive arrangements, but not later than when such inventory is sold through to the wholesalers' customers, on a first-in first-out basis (FIFO).

In the case of new products for which the product introduction is not an extension of an existing line of product, where the Company determines that there are not products in a similar therapeutic category, or where the Company determines the new product has dissimilar characteristics with existing products, such that the Company cannot reliably estimate expected returns of the new product, the Company defers recognition of revenue until the right of return no longer exists or until the Company has developed sufficient historical experience to estimate sales returns.

Sales Rebate and Return Accruals

Medicaid rebate accruals were \$137 million and \$326 million at December 31, 2006 and 2005, respectively; Women, Infants and Children (WIC) rebate accruals were \$230 million and \$252 million at December 31, 2006 and 2005, respectively; sales return accruals were \$221 million and \$185 million at December 31, 2006 and 2005, respectively; and managed health care rebate and other contractual discount accruals were \$111 million and \$167 million at December 31, 2006 and 2005, respectively. These and other rebate accruals were established in the same period the related revenue was recognized, resulting in a reduction to sales and the establishment of a liability, which is included in accrued liabilities. An accrual is recorded based on an estimate of the proportion of recorded revenue that will result in a rebate or return. Prime vendor charge-back accruals, established in a similar manner, are recorded as a reduction to accounts receivable and were \$63 million and \$107 million at December 31, 2006 and 2005, respectively.

Income Taxes

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. The assessment of whether or not a valuation allowance is required often requires significant judgment including the long-range forecast of future taxable income and the evaluation of tax planning initiatives. Adjustments to the deferred tax valuation allowances are made to earnings in the period when such assessments are made. As of December 31, 2006 and 2005, the Company had net deferred tax assets of \$3,154 million and \$2,380 million, respectively, net of valuation allowances of \$625 million and \$559 million, respectively.

The Company has recorded significant deferred tax assets related to U.S. foreign tax credit carryforwards of approximately \$1,071 million and U.S. research tax credit carryforwards of approximately \$259 million, which expire in varying amounts beginning in 2012. Realization of the foreign tax credit and research tax credit carryforwards is dependent on generating sufficient domestic taxable income prior to their expiration. Although realization is not assured, management believes it is more likely than not that these deferred tax assets will be realized. The Company anticipates increasing its level of domestic profitability over time by undertaking actions such as increasing its biologics manufacturing capacity in the U.S. and implementing tax planning strategies. While increasing domestic profitability will likely cause the Company's effective tax rate to increase, it will also further enhance the Company's ability to utilize its foreign tax credit and research tax credit carryforwards. The amount of foreign tax credit and research tax credit carryforwards considered realizable, however, could be reduced in the near term if Plavix is subject to either renewed or additional generic competition. If such events occur, the Company may need to record significant valuation allowances against these U.S. Federal deferred tax assets. For a discussion of Plavix related matters, see Note 21 "Legal Proceedings and Contingencies."

As of December 31, 2006, the Company had approximately \$11.3 billion of undistributed earnings of foreign subsidiaries for which taxes have not been provided as the Company has invested or expects to invest these undistributed earnings permanently offshore. If in the future these earnings are repatriated to the U.S., or if the Company determines such earnings will be remitted in the foreseeable future, additional tax provisions would be required. Due to complexities in the tax laws and the assumptions that would have to be made, it is not practicable to estimate the amounts of income taxes that would have to be provided.

The Company conducts business in various countries throughout the world and is subject to tax in numerous jurisdictions. As a result of its business activities, the Company files a significant number of tax returns that are subject to examination by various Federal, state and local tax authorities. Tax examinations are often complex as tax authorities may disagree with the treatment of items reported by the Company and may require several years to resolve. The Company establishes liabilities for possible assessments by tax authorities resulting from known tax exposures including, but not limited to, transfer pricing matters, tax credits, and deductibility of certain expenses. Such liabilities represent a reasonable provision for taxes ultimately expected to be paid, and may need to be adjusted over time as more information becomes known.

Cash and Cash Equivalents

Cash equivalents are primarily highly liquid investments with original maturities of three months or less at the time of purchase, and are recorded at cost, which approximates fair value.

Marketable Securities

The Company accounts for marketable securities in accordance with Statement of Financial Accounting Standard (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The Company determined the appropriate classification of all marketable securities was "available-for-sale" at the time of purchase. As such, at December 31, 2006 and 2005, all of the Company's investments in marketable securities were reported at fair value. Unrealized gains and losses are reported as a component of accumulated other comprehensive income (loss) in stockholders' equity. The Company follows its investment managers' method of determining the cost basis in computing realized gains and losses on the sale of its available-for-sale securities, which is the average cost method. Realized gains and losses are included in other income (expense).

Inventory Valuation

Inventories are generally stated at average cost, not in excess of market.

Capital Assets and Depreciation

Expenditures for additions, renewals and improvements are capitalized at cost. Depreciation is generally computed on a straight-line method based on the estimated useful lives of the related assets. The estimated useful lives of the major classes of depreciable assets are 50 years for buildings and 3 to 40 years for machinery, equipment and fixtures. The Company periodically evaluates whether current events or circumstances indicate that the carrying value of its depreciable assets may not be recoverable.

Impairment of Long-Lived Assets

The Company periodically evaluates whether current facts or circumstances indicate that the carrying value of its depreciable assets to be held and used may not be recoverable. If such circumstances are determined to exist, an estimate of undiscounted future cash flows produced by the long-lived asset, or the appropriate grouping of assets, is compared to the carrying value to determine whether impairment exists. If an asset is determined to be impaired, the loss is measured based on the difference between the asset's fair value and its carrying value. An estimate of the asset's fair value is based on quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including a discounted value of estimated future cash flows. The Company reports an asset to be disposed of at the lower of its carrying value or its estimated net realizable value.

Capitalized Software

Certain costs to obtain internal use software for significant systems projects are capitalized and amortized over the estimated useful life of the software, which ranges from 3 to 10 years. Costs to obtain software for projects that are not significant are expensed as incurred. Capitalized software, net of accumulated amortization, included in other intangible assets, was \$291 million and \$336 million, at December 31, 2006 and 2005, respectively. Amortization expense was \$124 million, \$116 million and \$90 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Investments

The Company accounts for 50% or less owned companies over which it has the ability to exercise significant influence using the equity method of accounting, otherwise the cost method is used. The Company's share of net income or losses of equity investments is included in equity in net income of affiliates in the consolidated statement of earnings. Losses are recognized in other income (expense) when a decline in market value is deemed to be other than temporary. The Company reviews its equity investments for impairment based on its determination of whether the decline in market value of the investment below the Company's carrying value is other than temporary. In making this determination, the Company considers Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* and related interpretations, which set forth factors to be evaluated in determining whether a loss in value should be recognized, including the Company's ability to hold its investment, the market price and market price fluctuations of the investment's publicly traded shares and inability of the investee to sustain an earnings capacity, which would justify the carrying amount of the investment.

Goodwill and Other Intangible Assets

Goodwill is tested for impairment annually using a two-step process. The first step is to identify a potential impairment, and the second step measures the amount of the impairment loss, if any. Goodwill is deemed to be impaired if the carrying amount of a reporting unit's goodwill exceeds its estimated fair value. The Company has completed its goodwill impairment assessment, which indicated no impairment of goodwill.

Other intangible assets, consisting of patents, trademarks, technology, licenses, and capitalized software, are amortized on a straight-line basis over their useful lives, ranging from 3 to 17 years. Indefinite-lived intangible assets, if any, are tested for impairment using a one-step process, which consists of a comparison of the fair value to the carrying value of the intangible asset. Such intangible assets are deemed to be impaired if their net carrying value exceeds their estimated fair value. All other intangible assets are evaluated for impairment as described under "—Impairment of Long-Lived Assets" above.

Restructuring

To streamline operations and rationalize manufacturing facilities, the Company has periodically recorded restructuring charges. As a result, the Company has made estimates and judgments regarding its future plans, including future termination benefits and other exit costs to be incurred when the restructuring actions take place. Actual results may or may not vary from these estimates.

Product Liability

Accruals for product liability (including associated legal costs) are recorded on an undiscounted basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated based on existing information. These accruals are adjusted periodically as assessment efforts progress or as additional information becomes available. Receivables for related insurance or other third-party recoveries for product liabilities are recorded, on an undiscounted basis, when it is probable that a recovery will be realized and are classified as a reduction of litigation charges in the consolidated statement of earnings.

Contingencies

In the normal course of business, the Company is subject to loss contingencies, such as legal proceedings and claims arising out of its business, that cover a wide range of matters, including, among others, government investigations, shareholder lawsuits, product and environmental liability, and tax matters. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company records accruals for such loss contingencies when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. The Company, in accordance with SFAS No. 5, does not recognize gain contingencies until realized. For a discussion of contingencies, see Note 8 “Income Taxes” and Note 21 “Legal Proceedings and Contingencies.”

Derivative Financial Instruments

Derivative financial instruments are used by the Company principally in the management of its interest rate and foreign currency exposures. The Company does not hold or issue derivative financial instruments for speculative purposes.

The Company records all derivative instruments on the balance sheet at fair value. Changes in a derivative’s fair value are recognized in earnings unless specific hedge criteria are met. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in the consolidated statement of earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income (loss) and are subsequently recognized in the consolidated statement of earnings when the hedged item affects earnings; cash flows are classified consistent with the underlying hedged item. For purchased foreign currency options the entire change in fair value is included in the measurement of hedge effectiveness for cash flow hedges. Ineffective portions of changes in the fair value of cash flow hedges, if any, are recognized as a charge or credit to earnings.

The Company designates and assigns derivatives as hedges of forecasted transactions, specific assets or specific liabilities. When hedged assets or liabilities are sold or extinguished or the forecasted transactions being hedged are no longer expected to occur, the Company immediately recognizes the gain or loss on the designated hedging financial instruments in the consolidated statement of earnings.

Shipping and Handling Costs

The Company typically does not charge customers for shipping and handling costs. Therefore, shipping and handling costs are included in marketing, selling and administrative expenses and were \$269 million in 2006 and \$245 million in both 2005 and 2004.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was \$481 million, \$509 million and \$479 million in 2006, 2005 and 2004, respectively.

Research and Development

Research and development costs are expensed as incurred. The Company from time to time will enter into strategic alliances with third parties, which give the Company rights to develop, manufacture, market and/or sell pharmaceutical products, the rights to which are owned by such third parties. As a result of these alliances, the Company may be obligated to make payments to alliance partners in connection with research and development contingent upon the achievement of certain pre-determined criteria. For milestones achieved prior to regulatory approval of the product, such payments are expensed as research and development. Milestone payments made in connection with regulatory approvals, including non-U.S. regulatory approvals and additional indications, are capitalized and amortized to cost of products sold over the remaining useful life of the asset. All capitalized milestone payments are tested for recoverability periodically or whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable.

Acquired In-Process Research and Development

The fair value of in-process research and development acquired in a business combination is determined by independent appraisal based on the present value of each research project’s projected cash flows. An income approach is utilized that is consistent with guidance in the practice aid issued by the American Institute of Certified Public Accountants, *Assets Acquired in Business Combinations to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices and Pharmaceutical Industries*. Future cash flows are predominately based on the net income forecast of each project, consistent with historical pricing, margins and expense levels of similar products. Revenues are estimated based on relevant market size and growth factors, expected industry trends, individual project life cycles and the life of each research project’s underlying patent. In determining the fair value of each research project, expected revenues are first adjusted for technical risk of completion. The resulting cash flows are then discounted at a rate approximating the Company’s weighted average cost of capital. Other acquired in-process research and development is expensed as incurred when the underlying product has not received regulatory approval and does not have any future alternative use. In addition, costs that are nonrefundable, related to the acquisition or licensing of products that have not yet received regulatory approval to be marketed and that have no alternative future use, are charged to earnings as incurred.

Earnings Per Share

Basic earnings per common share are computed using the weighted-average number of shares outstanding during the year. Diluted earnings per common share are computed using the weighted-average number of shares outstanding during the year plus the incremental shares outstanding assuming the exercise of dilutive stock options, restricted stock and convertible instruments.

Foreign Currency Translation

The statements of earnings of the Company's foreign subsidiaries are translated into U.S. dollars using average exchange rates. The net assets of the Company's foreign subsidiaries are translated into U.S. dollars using current exchange rates. The U.S. dollar effects that arise from translating the net assets of these subsidiaries at changing rates are recorded in the foreign currency translation adjustment account, which is included in accumulated other comprehensive income (OCI).

Recently Issued Accounting Standards

The Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors based on estimated fair values. SFAS No. 123(R) supersedes the Company's previous accounting under APB No. 25, *Accounting for Stock Issued to Employees*, for periods beginning January 1, 2006. In March 2005, the U.S. Securities and Exchange Commission (SEC) issued SAB No. 107, *Share-Based Payment* relating to SFAS No. 123(R). The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, and has elected the alternative method as provided in FASB Staff Position (FSP) 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*, in determining the Company's pool of excess tax benefits. The Company's consolidated financial statements for the year ended December 31, 2006 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Stock-based compensation expense recognized under SFAS No. 123(R) for the year ended December 31, 2006 was \$112 million (\$73 million, net of tax) or \$0.04 per share, with a corresponding amount recorded in additional paid-in capital within stockholders' equity. Additionally, \$10 million related to performance awards was reclassified from liabilities to stockholders' equity in connection with the adoption of SFAS No. 123(R).

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits an entity to measure certain financial assets and financial liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option (by instrument) will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option election is irrevocable, unless a new election date occurs. SFAS No. 159 establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. This Statement is effective for fiscal years beginning after November 15, 2007. The Company is evaluating the potential impact of this pronouncement.

In September 2006, the FASB issued Statement SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. This pronouncement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. This pronouncement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The pronouncement does not require prior periods to be restated to reflect the impact of SFAS No. 158. The Company adopted SFAS No. 158 in the fiscal year ended December 31, 2006 and the adoption of this accounting pronouncement resulted in a \$1,064 million reduction of accumulated OCI in stockholders' equity, a \$767 million reduction in total assets and a \$297 million increase in total liabilities. The adoption of SFAS No. 158 did not impact the Company's results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This pronouncement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement is effective for fiscal years beginning after November 15, 2007. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying the Misstatements in Current Year Financial Statements*, which expresses the staff's views regarding the process of quantifying financial statement misstatements. This bulletin is effective for any interim period of the first fiscal year ending after November 15, 2006. SAB No. 108 requires that companies utilize a "dual approach" to assess the quantitative effects of financial statement misstatements. The dual approach includes both an income statement focus and balance sheet focus assessment. The adoption of this bulletin did not have any effect on the Company's consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation Number (FIN) No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* which, in the case of the Company, is effective as of January 1, 2007. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN No. 48 requires that all tax positions be evaluated using a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Differences between tax positions taken in a tax return and amounts recognized in the financial statements are recorded as adjustments to income taxes payable or receivable, or adjustments to deferred taxes, or both. FIN No. 48 also requires expanded disclosure at the end of each annual reporting period including a tabular reconciliation of unrecognized tax benefits. In accordance with FIN No. 48, the Company will report the difference between the net amount of assets and liabilities recognized in the statement of financial position prior to and after the application of FIN No. 48 as a cumulative effect adjustment to the opening balance of retained earnings. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*. This pronouncement relates to the accounting for separately recognized servicing assets and servicing liabilities. This Statement is effective for fiscal years beginning after September 15, 2006. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140*. This pronouncement primarily resolves certain issues addressed in the implementation of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, concerning beneficial interests in securitized financial assets. The Statement is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of the 2007 fiscal year. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. This pronouncement applies to all voluntary changes in accounting principle, and revises the requirements for accounting for and reporting a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable to do so. This pronouncement also requires that a change in the method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS No. 154. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

In March 2005, the FASB issued FIN No. 47, *Accounting for Conditional Asset Retirement Obligations*. FIN No. 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. Asset retirement obligations covered by FIN No. 47 are those for which an entity has a legal obligation to perform an asset retirement activity, even if the timing and method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company adopted the provisions of FIN No. 47 in the fiscal year ended December 31, 2005 and adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

In December 2004, the FASB issued FSP No. 109-1— *Application of SFAS No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. FSP No. 109-1 provides that the *Deduction on Qualified Production Activities* will be treated as a "special deduction" as described in SFAS No. 109, *Accounting for Income Taxes*. Accordingly, the tax effect of this deduction was reported as a component of the Company's tax provision and did not have an effect on deferred tax assets and liabilities. On May 24, 2006, the Internal Revenue Service (IRS) issued Final Tax Regulations (FTR) with respect to the *Deduction on Qualified Production Activities* under Section 199 of the Internal Revenue Code. The final regulations are effective for taxable years beginning on or after June 1, 2006. For taxable years beginning prior to the

effective date of the final regulations, a taxpayer may apply either: (1) the final regulations, provided the taxpayer applies all provisions in the final regulations; or (2) subject to certain limitations, the rules provided in Notice 2005-24, as well as the proposed regulations. The issuance of the FTR and the adoption of the FSP No. 109-1 did not have a material impact on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The provisions of this Statement should be applied prospectively, and eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs – an Amendment of ARB No. 43, Chapter 4*. The standard requires abnormal amounts of idle facility and related expenses to be recognized as current period charges and also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements.

Note 2 Alliances and Investments

Sanofi-Aventis

The Company has agreements with Sanofi-Aventis (Sanofi) for the codevelopment and cocommercialization of Avapro/Avalide (irbesartan), an angiotensin II receptor antagonist indicated for the treatment of hypertension and diabetic nephropathy, and Plavix (clopidogrel bisulfate), a platelet aggregation inhibitor. The worldwide alliance operates under the framework of two geographic territories; one in the Americas (principally the U.S., Canada, Puerto Rico and Latin American countries) and Australia, and the other in Europe and Asia. Accordingly, two territory partnerships were formed to manage central expenses, such as marketing, research and development, and royalties, and to supply finished product to the individual countries. In general, at the country level, agreements either to copromote (whereby a partnership was formed between the parties to sell each brand) or to comarket (whereby the parties operate and sell their brands independently of each other) are in place. The agreements expire on the later of (i) with respect to Plavix, 2013 and, with respect to Avapro/Avalide, 2012 in the Americas and Australia and 2013 in Europe and Asia and (ii) the expiration of all patents and other exclusivity rights in the applicable territory.

The Company acts as the operating partner for the territory covering the Americas and Australia and owns a 50.1% majority controlling interest in this territory. Sanofi's ownership interest in this territory is 49.9%. As such, the Company consolidates all country partnership results for this territory and records Sanofi's share of the results as a minority interest, net of taxes, which was \$428 million in 2006, \$578 million in 2005 and \$502 million in 2004. The Company recorded sales in this territory and in comarketing countries outside this territory (Germany, Italy, Spain and Greece) of \$4,355 million in 2006, \$4,805 million in 2005 and \$4,257 million in 2004.

Cash flows from operating activities of the partnerships in the territory covering the Americas and Australia are recorded as operating activities within the Company's consolidated statement of cash flows. Distributions of partnership profits to Sanofi and Sanofi's funding of ongoing partnership operations occur on a routine basis and are also recorded within operating activities on the Company's consolidated statement of cash flows.

Sanofi acts as the operating partner of the territory covering Europe and Asia and owns a 50.1% majority financial controlling interest within this territory. The Company's ownership interest in the partnerships within this territory is 49.9%. The Company accounts for the investment in partnership entities in this territory under the equity method and records its share of the results in equity in net income of affiliates in the consolidated statement of earnings. The Company's share of net income from these partnership entities before taxes was \$439 million in 2006, \$345 million in 2005 and \$269 million in 2004.

The Company routinely receives distributions of profits and provides funding for the ongoing operations of the partnerships in the territory covering Europe and Asia. These transactions are recorded as operating activities within the Company's consolidated statement of cash flows.

In 2001, the Company and Sanofi (the Companies) formed an alliance for the copromotion of irbesartan, as part of which the Company contributed the irbesartan distribution rights in the U.S. and Sanofi paid the Company a total of \$350 million in the two years ended December 31, 2002. The Company accounted for this transaction as a sale of an interest in a license and deferred and is amortizing the \$350 million to other income over the expected useful life of the license, which is approximately 11 years from the

formation of the irbesartan copromotion alliance. The Company recognized other income of \$31 million, \$31 million and \$32 million in 2006, 2005 and 2004, respectively. The unamortized portion of the deferred income is recorded in the liabilities section of the consolidated balance sheet and was \$186 million and \$217 million as of December 31, 2006 and 2005, respectively.

Otsuka

The Company has a worldwide commercialization agreement with Otsuka Pharmaceutical Co., Ltd. (Otsuka), to codevelop and copromote, with Otsuka, Abilify (aripiprazole) for the treatment of schizophrenia and related psychiatric disorders, except in Japan, China, Taiwan, North Korea, South Korea, the Philippines, Thailand, Indonesia, Pakistan and Egypt. The product is currently copromoted with Otsuka in the United Kingdom (UK), Germany, France and Spain. In the U.S., Germany and Spain, where the product is sold by an Otsuka affiliate as distributor, the Company records alliance revenue for its 65% contractual share of Otsuka's net sales and records all expenses related to the product. The Company recognizes this alliance revenue when Abilify is shipped and all risks and rewards of ownership have transferred to Otsuka's customers. In the UK, France and Italy, where the Company is presently the exclusive distributor for the product, the Company records 100% of the net sales and related cost of products sold and expenses.

The Company also has an exclusive right to sell Abilify in other countries in Europe, the Americas and a number of countries in Asia. In these countries the Company records 100% of the net sales and related cost of products sold. Under the terms of the agreement, the Company purchases the product from Otsuka and performs finish manufacturing for sale by the Company to its customers. The agreement expires in November 2012 in the U.S. and Puerto Rico. For the entire European Union (EU), the agreement expires in June 2014. In each other country where the Company has the exclusive right to sell Abilify, the agreement expires on the later of the tenth anniversary of the first commercial sale in such country or expiration of the applicable patent in such country.

The Company recorded total revenue for Abilify of \$1,282 million in 2006, \$912 million in 2005 and \$593 million in 2004. Total milestone payments made to Otsuka under the agreement through December 2006 were \$217 million, of which \$157 million was expensed as acquired in-process research and development in 1999. The remaining \$60 million was capitalized in other intangible assets and is amortized in cost of products sold over the remaining life of the agreement in the U.S., ranging from 8 to 11 years. The Company amortized in cost of products sold \$6 million in 2006, \$6 million in 2005 and \$5 million in 2004. The unamortized capitalized payment balance was \$35 million and \$41 million as of December 31, 2006 and 2005, respectively.

ImClone

The Company has a commercialization agreement expiring in September 2018 with ImClone Systems Incorporated (ImClone), a biopharmaceutical company focused on developing targeted cancer treatments, for the codevelopment and copromotion of Erbitux in the U.S. In 2004, the U.S. Food and Drug Administration (FDA) approved the Biologics License Application (BLA) for Erbitux for use in combination with irinotecan in the treatment of patients with Epidermal Growth Factor Receptor (EGFR)-expressing, metastatic colorectal cancer who are refractory to irinotecan-based chemotherapy and for use as a single agent in the treatment of patients with EGFR-expressing, metastatic colorectal cancer who are intolerant to irinotecan-based chemotherapy. Also in 2004, the FDA approved ImClone's Chemistry, Manufacturing and Controls supplemental BLA for licensure of its BB36 manufacturing facility. In March 2006, the FDA approved Erbitux for use in the treatment of squamous cell carcinoma of the head and neck in combination with radiation or as monotherapy. The Company paid \$250 million as a milestone payment to ImClone for each of the FDA approvals in 2004 and 2006. Under the agreement, ImClone receives a distribution fee based on a flat rate of 39% of net sales in North America. In addition, the Company has the co-exclusive right to commercialize Erbitux in Japan (ImClone having previously granted co-exclusive right to Merck KGaA in Japan). In December 2004, the Company, its Japanese affiliate (BMKK), Merck KGaA, Merck Ltd., and ImClone executed a joint development agreement for Erbitux in Japan. Erbitux is not yet marketed in Japan, although an application has been submitted with the Japanese Pharmaceuticals and Medical Devices Agency for the use of Erbitux in treating patients with advanced colorectal cancer.

The Company accounts for the \$500 million approval milestones paid in 2004 and 2006 as license acquisitions, which were capitalized and are being amortized into cost of products sold over the remaining term of the agreement, which ends in 2018. In 2006, 2005 and 2004, the Company amortized into cost of products sold \$34 million, \$17 million and \$14 million, respectively. The unamortized portion of the approval payments is recorded in other intangible assets, and was \$435 million and \$219 million at December 31, 2006 and 2005, respectively.

The Company accounts for its investment in ImClone under the equity method and records its share of the results in equity in net income of affiliates in the consolidated statement of earnings. The Company's recorded investment and the market value of its holdings in ImClone common stock was \$109 million and approximately \$385 million as of December 31, 2006, respectively, and \$66 million and approximately \$493 million as of December 31, 2005, respectively. The Company holds 14.4 million shares of ImClone stock, representing approximately 17% of ImClone's shares outstanding at December 31, 2006 and 2005. On a per share basis, the

carrying value of the ImClone investment and the closing market price of the ImClone shares as of December 31, 2006 were \$7.59 and \$26.76, respectively, compared to \$4.55 and \$34.24, respectively, as of December 31, 2005.

The Company determines its equity share in ImClone's net income or loss by eliminating from ImClone's results the milestone revenue ImClone recognizes for the \$400 million in pre-approval milestone payments made by the Company from 2001 through 2003. The Company recorded \$80 million of the pre-approval milestone payments as an equity investment and expensed the remaining \$320 million as acquired in-process research and development during that period. Milestone revenue recognized by ImClone in excess of \$400 million is not eliminated by the Company in determining its equity share in ImClone's results. For its share of ImClone's results of operations, the Company recorded net income of \$43 million in 2006, a net loss of \$5 million in 2005, and net income of \$9 million in 2004. The Company recorded net sales for Erbitux of \$652 million in 2006, \$413 million in 2005 and \$261 million in 2004.

Gilead

In 2004, the Company and Gilead Sciences, Inc. (Gilead) entered into a joint venture to develop and commercialize a fixed-dose combination of the Company's *Sustiva* (efavirenz) and Gilead's Truvada (emtricitabine and tenofovir disoproxil fumarate) in the U.S. and Canada. In July 2006, the FDA granted approval of Atripla (efavirenz 600 mg/ emtricitabine 200 mg/ tenofovir disoproxil fumarate 300 mg) for the treatment of human immunodeficiency virus (HIV) infection in adults. Atripla is the first-ever once-daily single tablet regimen for HIV intended as a stand-alone therapy or in combination with other antiretrovirals.

Gilead records 100% of Atripla revenues and consolidates the results of the joint venture in its operating results. The Company records revenue for the bulk efavirenz component of Atripla upon sales of that product by the Gilead joint venture to third party customers. The Company's revenue for the efavirenz component is determined by applying a percentage to Atripla revenue, which approximates revenue for the *Sustiva* brand. In 2006, the Company recorded efavirenz revenues of \$76 million related to Atripla sales. The Company accounts for its participation in the joint venture under the equity method of accounting and records its share of the joint venture results in equity in net income of affiliates in the consolidated statement of earnings. The Company recorded an equity loss on the joint venture with Gilead of \$6 million and \$4 million for the year ended December 31, 2006 and 2005, respectively.

Summary Financial Information

The summarized financial information for the Company's equity investments in a joint venture with Sanofi in Europe and Asia were as follows:

Dollars in Millions	2006	2005	2004
Revenues	\$ 2,785	\$ 2,436	\$ 2,038
Gross profit	2,156	1,875	1,576
Net income	942	709	559
Current assets	1,595	1,398	1,142
Current liabilities	1,595	1,398	1,142

Note 3 Restructuring

2006 Activities

During 2006, the Company recorded pre-tax charges of \$73 million, related to the termination benefits and other related costs for workforce reductions for approximately 1,080 selling, operating and administrative personnel. These charges were decreased by \$14 million of adjustments reflecting changes in estimates for restructuring actions taken in prior periods.

The following table presents a detail of the charges by segment and type. The Company expects to substantially complete these activities during 2008.

Dollars in Millions	Termination Benefits	Other Exit Costs	Total
Pharmaceuticals	\$ 62	\$ 1	\$ 63
Nutritionals	3	1	4
Other Health Care	6	—	6
Subtotal	71	2	73
Changes in estimates	(13)	(1)	(14)
Restructuring as reflected in the statement of earnings	\$ 58	\$ 1	\$ 59

2005 Activities

During 2005, the Company recorded pre-tax charges of \$33 million, related to the termination benefits and other related costs for workforce reductions and streamlining of worldwide operations. Of these charges, \$31 million related to employee termination benefits and related expenses for approximately 640 selling and administrative personnel, which includes the restructuring of its U.S. cardiovascular/metabolics primary care sales organization and workforce headcount reduction, \$1 million related to retention bonuses and \$1 million related to asset impairments. These charges were decreased by \$1 million of adjustments reflecting changes in estimates for restructuring actions taken in prior periods.

The following table presents a detail of the charges by segment and type. The Company has substantially completed these restructuring activities in late 2006.

Dollars in Millions	Termination Benefits	Other Exit Costs	Relocation and Retention	Asset Write-Downs	Total
Pharmaceuticals	\$ 27	\$ 1	\$ 1	\$ 1	\$ 30
Nutritionals	1	—	—	—	1
Other Health Care	2	—	—	—	2
Subtotal	30	1	1	1	33
Changes in estimates	(3)	2	—	—	(1)
Restructuring as reflected in the statement of earnings	\$ 27	\$ 3	\$ 1	\$ 1	\$ 32

2004 Activities

During 2004, the Company recorded pre-tax charges of \$116 million, relating to the termination benefits and other related costs for workforce reduction and streamlining of worldwide operations. Of these charges, \$107 million primarily related to employee termination benefits and related expenses for approximately 2,000 selling, administrative and manufacturing personnel, \$1 million related primarily to asset impairments, \$6 million related to the consolidation of certain research facilities and \$2 million to retention bonuses. These charges were partially offset by \$8 million of adjustments reflecting changes in estimates for restructuring actions taken in prior periods and a \$4 million gain on sale of a research facility previously written off as restructuring.

The following table presents a detail of the charges by segment and type. The Company has substantially completed these restructuring activities.

Dollars in Millions	Termination Benefits	Other Exit Costs	Relocation and Retention	Asset Write-Downs	Total
Pharmaceuticals	\$ 73	\$ 5	\$ 8	\$ 1	\$ 87
Other Health Care	18	—	—	—	18
Corporate/Other	11	—	—	—	11
Subtotal	102	5	8	1	116
Changes in estimates	(7)	—	—	(1)	(8)
Gain in sale of research facility	—	—	—	(4)	(4)
Restructuring as reflected in the statement of earnings	\$ 95	\$ 5	\$ 8	\$ (4)	\$ 104

Rollforward

Restructuring charges and spending against liabilities associated with prior and current actions were as follows:

Dollars in Millions	Employee Termination Liability	Other Exit Cost Liability	Total
Balance at January 1, 2004	\$ 51	\$ 7	\$ 58
Charges	102	5	107
Spending	(68)	(9)	(77)
Changes in estimate	(7)	(1)	(8)
Balance at December 31, 2004	78	2	80
Charges	30	2	32
Spending	(45)	(6)	(51)
Changes in estimate	(3)	2	(1)
Balance at December 31, 2005	60	—	60
Charges	71	2	73
Spending	(44)	—	(44)
Changes in estimate	(13)	(1)	(14)
Balance at December 31, 2006	\$ 74	\$ 1	\$ 75

Liabilities of \$32 million and \$60 million at December 31, 2006 and 2005, respectively, are included in accrued expenses in the consolidated balance sheet. A long-term liability of \$43 million is included in other liabilities at December 31, 2006.

Note 4 Acquisitions and Divestitures

In January 2006, the Company completed the sale of its inventory, trademark, patent and intellectual property rights in the U.S. related to Dovonex, a treatment for psoriasis, to Warner Chilcott Company, Inc. for \$200 million in cash. In addition, the Company will receive a royalty based on 5% of net sales of Dovonex through the end of 2007. As a result of this transaction, the Company recognized a pre-tax gain of \$200 million (\$130 million net of tax) in the first quarter of 2006.

In the third quarter of 2005, the Company completed the sale of its U.S. and Canadian Consumer Medicines (Consumer Medicines) business and related assets to Novartis AG (Novartis). Under the terms of the agreement, Novartis acquired the trademarks, patents and intellectual property rights of Consumer Medicines for \$661 million in cash, including the impact of a working capital adjustment, of which \$15 million is attributable to a post-closing supply arrangement between the Company and Novartis. The related assets include the rights to the U.S. Consumer Medicines brands in Latin America, Europe, the Middle East and Africa. The results of operations of Consumer Medicines are included in the Company's consolidated statement of earnings up to the date of disposal. As a result of this transaction, the Company recorded a pre-tax gain of \$569 million (\$370 million net of tax) in the third quarter of 2005.

In April 2004, the Company completed the acquisition of Acordis Speciality Fibres (Acordis). The Company purchased all the stock of Acordis for \$150 million and incurred \$8 million of acquisition costs in connection with the transaction. In December 2006, the Company accrued a \$9 million liability based on the achievement of production volumes, which was recorded as additional goodwill. The purchase price for the acquisition was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. Of the \$158 million, \$63 million was allocated to in-process research and development, which was immediately expensed, and \$22 million was assigned to identifiable intangible assets, predominantly patents. The excess of the purchase price over the estimated fair values of net assets acquired was recorded as goodwill. This acquisition was accounted for by the purchase method, and, accordingly, results of operations have been included in the accompanying consolidated financial statements from the date of acquisition.

In February 2004, the Company completed the divestiture of its Adult Nutritional business to Novartis for \$386 million, including \$20 million contingent on the achievement of contractual requirements, which were satisfied, and a \$22 million upfront payment for a supply agreement. The Company recorded a total pre-tax gain of \$320 million (\$198 million net of tax), which included the \$20 million contingent payment and a \$5 million reduction in Company goodwill associated with the Mead Johnson product lines.

Note 5 Discontinued Operations

In May 2005, the Company completed the sale of Oncology Therapeutics Network (OTN) to One Equity Partners LLC for cash proceeds of \$197 million, including the impact of a preliminary working capital adjustment. The Company recorded a pre-tax gain of \$63 million (\$13 million net of tax), that was presented as a gain on sale of discontinued operations in the consolidated statement of earnings. OTN was previously presented as a separate segment.

The following amounts related to the OTN business have been segregated from continuing operations and reported as discontinued operations through the date of disposition, and do not reflect the costs of certain services provided to OTN by the Company. Such costs, which were not allocated by the Company to OTN, were for services, which included legal counsel, insurance, external audit fees, payroll processing, certain human resource services and information technology systems support.

Dollars in Millions	Year ended December 31,		
	2006	2005	2004
Net sales	—	\$ 1,015	\$ 2,506
(Loss)/earnings before incomes taxes	—	(8)	15
Net (loss)/earnings from discontinued operations	—	(5)	10

The consolidated statement of cash flows includes the OTN business through the date of disposition. The Company uses a centralized approach to the cash management and financing of its operations and accordingly, debt was not allocated to this business. Cash flows from operating activities of discontinued operations consist of outflows of \$265 million for the year ended December 31, 2005 and cash inflows of \$134 million for the year ended December 31, 2004. Cash flows used in investing activities of discontinued

operations were \$2 million for the year ended December 31, 2004 and there were no investing activities for the year ended December 31, 2005.

Note 6 Earnings Per Share

The numerator for basic earnings per share is net earnings available to common stockholders. The numerator for diluted earnings per share is net earnings available to common stockholders with interest expense added back for the assumed conversion of the convertible debt into common stock. The denominator for basic earnings per share is the weighted average number of common stock outstanding during the period. The denominator for diluted earnings per share is weighted average shares outstanding adjusted for the effect of dilutive stock options and assumed conversion of the convertible debt into common stock. The computations for basic and diluted earnings per common share were as follows:

Amounts in Millions, Except Per Share Data	Year Ended December 31,		
	2006	2005	2004
Basic:			
Earnings from Continuing Operations	\$ 1,585	\$ 2,992	\$ 2,378
Discontinued Operations			
Loss, net of taxes	—	(5)	10
Gain on Disposal, net of taxes	—	13	—
Net Earnings	\$ 1,585	\$ 3,000	\$ 2,388
Basic Earnings Per Share:			
Average Common Shares Outstanding	1,960	1,952	1,942
Earnings from Continuing Operations	\$ 0.81	\$ 1.53	\$ 1.23
Discontinued Operations			
Loss, net of taxes	—	—	—
Gain on Disposal, net of taxes	—	—	—
Net Earnings per Common Share	\$ 0.81	\$ 1.53	\$ 1.23
Diluted:			
Earnings from Continuing Operations	\$ 1,585	\$ 2,992	\$ 2,378
Interest expense on conversion of convertible debt, net of taxes ^(a)	—	22	7
Discontinued Operations			
Loss, net of taxes	—	(5)	10
Gain on Disposal, net of taxes	—	13	—
Net Earnings	\$ 1,585	\$ 3,022	\$ 2,395
Diluted Earnings Per Share:			
Average Common Shares Outstanding	1,960	1,952	1,942
Conversion of convertible debt ^(a)	—	29	29
Incremental shares outstanding assuming the exercise/vesting of dilutive stock options/restricted stock	3	2	5
	1,963	1,983	1,976
Earnings from Continuing Operations	\$ 0.81	\$ 1.52	\$ 1.21
Discontinued Operations			
Loss, net of taxes	—	—	—
Gain on Disposal, net of taxes	—	—	—
Net Earnings per Common Share	\$ 0.81	\$ 1.52	\$ 1.21

Weighted-average shares issuable upon the exercise of stock options, which were not included in the diluted earnings per share calculation because they were not dilutive, were 164 million in 2006, 156 million in 2005, and 126 million in 2004, respectively.

^(a) In 2006, the 29 million weighted-average shares issuable, as well as \$35 million of interest expense, net of tax, on the assumed conversion of convertible debt were not included in the diluted earnings per share calculation because they were not dilutive.

Note 7 Other Expense, Net

The components of other expense, net were as follows:

Dollars in Millions	Year Ended December 31,		
	2006	2005	2004
Interest expense	\$ 498	\$ 349	\$ 310
Interest income	(274)	(148)	(105)
Foreign exchange transaction losses	6	58	5
Other, net	69	(222)	(158)
Other expense, net	\$ 299	\$ 37	\$ 52

In 2006, interest expense was increased by net interest swap losses of \$18 million. In 2005 and 2004, interest expense was reduced by net interest swap gains of \$54 million and \$151 million, respectively. Interest income relates primarily to cash, cash equivalents and investments in marketable securities. Other, net includes income from third-party contract manufacturing, royalty income and expenses, debt retirement costs, certain other litigation matters, gains and losses on disposal of property, plant and equipment, gains and losses on sale of marketable securities and deferred income recognized. The change in Other, net in 2006 as compared to 2005, was primarily due to debt retirement costs and deferred income recognized.

Note 8 Income Taxes

The components of earnings (loss) from continuing operations before minority interest and income taxes were as follows:

Dollars in Millions	Year Ended December 31,		
	2006	2005	2004
U.S.	\$ (697)	\$ 809	\$ 478
Non-U.S.	3,332	3,707	3,940
	\$ 2,635	\$ 4,516	\$ 4,418

The above amounts are categorized based on the location of the taxing authorities.

The provision/(benefit) for income taxes attributable to continuing operations consisted of:

Dollars in Millions	Year Ended December 31,		
	2006	2005	2004
Current:			
U.S.	\$ 154	\$ 1,058	\$ 513
Non-U.S.	693	686	728
	847	1,744	1,241
Deferred:			
U.S.	(204)	(852)	264
Non-U.S.	(33)	40	14
	(237)	(812)	278
	\$ 610	\$ 932	\$ 1,519

Effective Tax Rate

The Company's provision for income taxes in 2006, 2005 and 2004 was different from the amount computed by applying the statutory U.S. Federal income tax rate to earnings from continuing operations before minority interest and income taxes, as a result of the following:

Dollars in Millions	% of Earnings Before Minority Interest and Income Taxes					
	2006		2005		2004	
Earnings from Continuing Operations Before Minority Interest and Income Taxes	\$ 2,635		\$ 4,516		\$ 4,418	
U.S. statutory rate	922	35.0%	1,581	35.0%	1,546	35.0%
Foreign tax effect of operations in Ireland, Puerto Rico and Switzerland	(616)	(23.3)%	(708)	(15.7)%	(660)	(14.9)%
State and local taxes (net of valuation allowance)	42	1.6 %	2	0.1%	(14)	(0.3)%
U.S. Federal & foreign contingent tax matters	87	3.3 %	114	2.5%	293	6.6%
Dividend repatriation under AJCA	—	—	(135)	(3.0)%	575	13.0%
U.S. Federal research tax credit	(85)	(3.2) %	(63)	(1.4)%	(20)	(0.5)%
U.S. Federal and foreign valuation allowance	(24)	(0.9) %	32	0.7%	142	3.2%
Foreign and other	284	10.7%	109	2.4%	(343)	(7.7)%
	\$ 610	23.2%	\$ 932	20.6%	\$ 1,519	34.4%

The effective income tax rate on earnings from continuing operations before minority interest and income taxes was 23.2% in 2006 compared with 20.6% in 2005 and 34.4% in 2004. The increase in the effective tax rate in 2006 compared to 2005 resulted from the elimination in 2006 of tax benefits under Section 936 of the Internal Revenue Code, the treatment of provisions for a portion of certain litigation reserves as non-deductible in 2006, tax benefits in 2005 associated with the settlement of an IRS examination and a favorable adjustment in 2005 to taxes on special dividends under the American Jobs Creation Act of 2004 (AJCA), partially offset by favorable U.S. tax legislation enacted in 2006 related to the tax treatment of certain inter-company transactions amongst the Company's foreign subsidiaries, and the implementation of tax planning strategies in 2006 related to the utilization of certain charitable contributions. The decrease in the effective tax rate in 2005 was due primarily to a charge in 2004 of approximately \$575 million for taxes on special dividends under AJCA, a 2004 charge related to the establishment of a valuation allowance against certain charitable contributions and tax benefits in 2005 discussed above, partially offset by lower estimated foreign tax credits in 2005.

Deferred Taxes and Valuation Allowance

The components of current and non-current deferred income tax assets (liabilities) were as follows:

Dollars in Millions	December 31,	
	2006	2005
Acquired in-process research and development	\$ 891	\$ 976
Inter-company profit and other inventory items	248	225
U.S. Federal foreign tax credit carryforward	1,071	975
Deferred income	99	136
U.S. Federal research and development tax credit carryforward	259	125
U.S. Federal charitable contribution carryforward	40	117
State net operating loss carryforwards	394	306
Foreign net operating loss carryforwards	196	100
Other foreign deferred tax assets	120	152
Pension and postretirement benefits ^(a)	396	(223)
Depreciation	(155)	(245)
Share based compensation	47	—
Legal settlements	101	127
Other, net	72	168
	3,779	2,939
Valuation allowance	(625)	(559)
Deferred tax assets, net	\$ 3,154	\$ 2,380
Recognized as:		
Deferred Income Taxes – Current	\$ 649	\$ 776
Deferred Income Taxes – Non-Current	2,577	1,808
U.S. and Foreign Income Taxes Payable	(4)	(26)
Other Liabilities – Non-Current	(68)	(178)
Total	\$ 3,154	\$ 2,380

(a) Includes the impact of a \$567 million increase in deferred tax benefits in 2006 on adoption of SFAS No. 158, see Note 20 “Pension and Other Postretirement Benefit Plans.”

The valuation allowance of \$625 million at December 31, 2006 relates to \$62 million of state deferred tax assets, \$187 million of foreign net operating loss and tax credit carryforwards, and \$376 million of state net operating loss and tax credit carryforwards that the Company currently believes are not likely to be realized.

The Company has recorded significant deferred tax assets related to U.S. foreign tax credit carryforwards of approximately \$1,071 million and U.S. research tax credit carryforwards of approximately \$259 million, which expire in varying amounts beginning in 2012. Realization of the foreign tax credit and research tax credit carryforwards is dependent on generating sufficient domestic taxable income prior to their expiration. Although realization is not assured, management believes it is more likely than not that these deferred tax assets will be realized. The Company anticipates increasing its level of domestic profitability over time by undertaking actions such as increasing its biologics manufacturing capacity in the U.S. and implementing tax planning strategies. While increasing domestic profitability will likely cause the Company’s effective tax rate to increase, it will also further enhance the Company’s ability to utilize its foreign tax credit and research tax credit carryforwards. The amount of foreign tax credit and research tax credit carryforwards considered realizable, however, could be reduced in the near term if Plavix is subject to either renewed or additional generic competition. If such events occur, the Company may need to record significant valuation allowances against these U.S. Federal deferred tax assets. For a discussion of Plavix related matters, see Note 21 “Legal Proceedings and Contingencies.”

Income taxes paid during the year were \$741 million, \$1,556 million and \$822 million in 2006, 2005 and 2004, respectively.

The current tax benefit realized upon the exercise of stock options is charged to capital in excess of par value of stock and amounted to \$10 million, \$19 million and \$26 million in 2006, 2005 and 2004, respectively.

As of December 31, 2006, the Company had approximately \$11.3 billion of undistributed earnings of foreign subsidiaries for which taxes have not been provided as the Company has invested or expects to invest these undistributed earnings permanently offshore. If in the future these earnings are repatriated to the U.S., or if the Company determines such earnings will be remitted in the foreseeable future, additional tax provisions would be required. Due to complexities in the tax laws and the assumptions that would have to be made, it is not practicable to estimate the amounts of income taxes that would have to be provided.

The Company conducts business in various countries throughout the world and is subject to tax in numerous jurisdictions. As a result of its business activities, the Company files a significant number of tax returns that are subject to examination by various Federal, state and local tax authorities. Tax examinations are often complex as tax authorities may disagree with the treatment of items reported by the Company and may require several years to resolve. The Company establishes liabilities for possible assessments by tax authorities resulting from known tax exposures including, but not limited to, transfer pricing matters, tax credits and deductibility of certain expenses. Such liabilities represent a reasonable provision for taxes ultimately expected to be paid, and may need to be adjusted over time as more information becomes known. The effect of changes in estimates related to contingent tax liabilities is included in the effective tax rate reconciliation above. In 2005, the Company recognized an income tax benefit of approximately \$159 million, due to the settlement of the Company's U.S. Federal income tax returns for the years 1998 through 2001.

The Company's U.S. Federal income tax returns for 2002 and 2003 are currently under examination by the IRS. The IRS has proposed (1) a significant disallowance of certain litigation settlement expenses and (2) a significant reduction in U.S. foreign tax credits claimed following the Company's previously disclosed 2002 international restructuring. The IRS' position on this latter matter also affects U.S. foreign tax credits claimed by the Company in 2004, although that year currently is not under examination.

While the Company believes that it has very strong positions with respect to both issues and intends to contest the IRS' positions, it is not possible to predict the outcome of these issues. The Company has established tax contingency reserves that reflect the best estimate of the probable tax liability for these matters. If the Company were not to prevail in a final, non-appealable determination of these matters the amount of loss in excess of established reserves could have a material adverse effect on the Company's results of operations, however the Company does not believe that such a determination would have a material adverse effect on its cash flows.

Note 9 Receivables

The major categories of receivables were as follows:

Dollars in Millions	December 31,	
	2006	2005
Trade receivables	\$ 2,400	\$ 2,797
Miscellaneous receivables	997	788
	3,397	3,585
Less allowances	150	207
Receivables, net	\$ 3,247	\$ 3,378

Miscellaneous receivables for 2006 and 2005 includes \$647 million, net of allowances of \$9 million and \$415 million, net of allowances of \$5 million, respectively, related to receivables from alliance partners. For additional information on the Company's alliance partners, see Note 2 "Alliances and Investments."

Note 10 Inventories

The major categories of inventories were as follows:

Dollars in Millions	December 31,	
	2006	2005
Finished goods	\$ 1,003	\$ 867
Work in process	682	679
Raw and packaging materials	394	514
Inventories, net	\$ 2,079	\$ 2,060

Note 11 Property, Plant and Equipment

The major categories of property, plant and equipment were as follows:

Dollars in Millions	December 31,	
	2006	2005
Land	\$ 254	\$ 280
Buildings	4,630	4,560
Machinery, equipment and fixtures	4,540	4,574
Construction in progress	720	570
	10,144	9,984
Less accumulated depreciation	4,471	4,291
Property, plant and equipment, net	\$ 5,673	\$ 5,693

Capitalized interest is \$18 million, \$9 million and \$10 million in the years ended December 31, 2006, 2005 and 2004, respectively, and is included in the categories of property, plant and equipment shown above.

Note 12 Goodwill

The changes in the carrying amount of goodwill for the years ended December 31, 2006 and 2005 were as follows:

Dollars in Millions	Pharmaceuticals Segment	Nutritionals Segment	Other Health Care Segment	Discontinued Operations	Total
Balance as of January 1, 2005	\$ 4,448	\$ 113	\$ 264	\$ 80	\$ 4,905
Adjustments:					
Reduction due to sale of OTN	—	—	—	(80)	(80)
Reduction due to sale of Consumer Medicines	—	—	(1)	—	(1)
Purchase price and allocation adjustment	—	—	(1)	—	(1)
Balance as of December 31, 2005	4,448	113	262	—	4,823
Adjustments:					
Reduction due to sale of business	(1)	—	—	—	(1)
Purchase price and allocation adjustments	(2)	—	9	—	7
Balance as of December 31, 2006	\$ 4,445	\$ 113	\$ 271	\$ —	\$ 4,829

Note 13 Other Intangible Assets

As of December 31, 2006 and 2005, other intangible assets consisted of the following:

Dollars in Millions	December 31,	
	2006	2005
Patents/Trademarks	\$ 258	\$ 269
Less accumulated amortization	145	113
Patents/Trademarks, net	113	156
Licenses	659	431
Less accumulated amortization	162	113
Licenses, net	497	318
Technology	1,787	1,787
Less accumulated amortization	836	676
Technology, net	951	1,111
Capitalized Software	844	761
Less accumulated amortization	553	425
Capitalized Software, net	291	336
Total other intangible assets, net	\$ 1,852	\$ 1,921

In the first quarter of 2006 and for the year 2005, the Company recorded impairment charges for licenses of \$32 million and \$42 million, respectively, resulting from actual and estimated future sales declines of *Tequin*. These charges were recorded in cost of products sold in the Company's consolidated statement of earnings.

In March 2006, as a result of the FDA approval of Erbitux for use in the treatment of head and neck cancer, the Company made a \$250 million milestone payment to ImClone, which was capitalized as licenses.

In the third quarter of 2006, the Company recorded an impairment charge for licenses of \$27 million, resulting from the lower than expected sales of EMSAM. This charge was recorded in cost of products sold in the Company's consolidated statement of earnings.

Amortization expense for other intangible assets for the years ended December 31, 2006, 2005 and 2004 was \$363 million, \$352 million and \$316 million, respectively.

Expected amortization expense related to the current net carrying amount of other intangible assets follows:

Years Ending December 31,	Dollars in Millions
2007	\$ 344
2008	291
2009	262
2010	248
2011	236
Later Years	471

Note 14 Short-Term Borrowings and Long-Term Debt

Short-term borrowings at the end of 2006 and 2005 were \$187 million and \$231 million, respectively. Long-term debt was \$7.2 billion at December 31, 2006 compared to \$8.4 billion at December 31, 2005.

During the fourth quarter of 2006, the Company restructured its long-term debt by retiring all of its outstanding \$2.5 billion, 5.75% Notes due 2011, through a cash tender offer and subsequent redemption and issuing €500 million (\$641 million) aggregate principal amount of 4.375% Notes due 2016 and €500 million (\$641 million) aggregate principal amount of 4.625% Notes due 2021, as well as \$1.25 billion aggregate principal amount of 5.875% Notes due 2036, which resulted in a \$220 million pre-tax expense, which are comprised of the items discussed below. The premium paid on the debt tender and make whole was \$72 million and \$24 million, respectively. In addition, the Company recognized in earnings \$12 million of unamortized discount and debt issuance costs associated with the 2011 debt, incurred a pre-tax loss of \$62 million related to the termination of the remaining \$2.0 billion notional amount of its 2011 fixed-to-floating interest rate swap agreements and recognized in earnings the pre-tax unamortized portion of \$18 million from the aforementioned loss incurred on the termination of \$500 million notional amount on the 2011 fixed-to-floating interest rate swaps that occurred in June 2005. Furthermore, in November 2006 the Company recognized in earnings from accumulated other comprehensive income the pre-tax unamortized portion of \$32 million from the loss incurred on the 2011 settlement of its interest rate lock contracts, which were used to manage its exposure to changes in interest rates for the anticipated issuance of the 2011 long-term fixed rate debt.

In December 2006, the Company replaced its prior \$2 billion revolving credit facility with a new \$2 billion, five-year revolving credit facility from a syndicate of lenders, which is extendable on the anniversary date with the consent of the lenders. This facility contains customary terms and conditions substantially similar to the prior facility, including a financial covenant whereby the ratio of consolidated debt to consolidated capital cannot exceed 50% at the end of each quarter. The Company has been in compliance with this covenant since the inception of this new facility. There were no borrowings outstanding under the revolving credit facility at December 31, 2006. The Company has unused short-term lines of credit and available trade finance facilities with foreign banks of \$402 million and \$394 million at December 31, 2006 and 2005, respectively.

In August 2005, a wholly-owned subsidiary of the Company entered into a \$2.5 billion term facility with a syndicate of bank lenders. Borrowings under this facility are guaranteed by the Company, the subsidiaries of the borrower and by certain European subsidiaries of the Company. This facility contained a five-year tranche of up to \$2.0 billion and a two-year tranche of up to \$500 million and was fully drawn at December 31, 2005. Interest is paid on a periodic basis, as agreed with the lenders, at an annual rate equal to the applicable London Interbank Offered Rate (LIBOR) plus 0.25%. The Company is subject to substantially the same covenants as those included in its December 2004 Revolving Credit facility. The Company is also subject to further restrictions, including certain financial covenants. Prior to borrowing any proceeds against this facility in 2005, the Company obtained a waiver from the lenders for a covenant default under this facility, due to a one-time intercompany distribution. As of December 31, 2006, the

Company had fully repaid the two-year tranche, had \$1.3 billion outstanding on the five-year tranche and was in full compliance with all covenants.

During the second quarter of 2005, the Company retired all of its outstanding \$2.5 billion 4.75% Notes due 2006, and incurred an aggregate pre-tax expense of approximately \$69 million in connection with the early redemption of the Notes and termination of related interest rate swaps.

The components of long-term debt were as follows:

Dollars in Millions	December 31,	
	2006	2005
5.75% Notes, due 2011	\$ —	\$ 2,425
Floating Rate Bank Term Facility, due 2010	1,300	2,000
5.875% Notes, due 2036	1,238	—
Floating Rate Convertible Debentures, due 2023 ⁽¹⁾	1,200	1,188
4.375% Euro Notes, due 2016	645	—
4.625% Euro Notes, due 2021	634	—
5.25% Notes, due 2013	588	593
Floating Rate Bank Term Facility, due 2007	—	500
4.00% Notes, due 2008	391	387
6.80% Debentures, due 2026	383	384
7.15% Debentures, due 2023	352	365
6.88% Debentures, due 2097	296	296
1.10% Yen Notes, due 2008	104	106
5.75% Industrial Revenue Bonds, due 2024	34	34
1.43% Yen Notes, due 2008	30	30
1.81% Yen Notes, due 2010	29	30
Variable Rate Industrial Revenue Bonds, due 2030	15	15
Other	9	11
	\$ 7,248	\$ 8,364

⁽¹⁾ The Company's outstanding \$1.2 billion of convertible debentures pay interest quarterly at an annual rate equal to 3-month LIBOR, reset quarterly, minus 0.50% (the yield never to be less than zero) and have a final maturity of September 15, 2023. The debentures are callable at par at any time on or after September 21, 2008 by the issuer. Holders can also redeem some or all of their debentures at par on September 15, 2008, 2013, and 2018, or if a fundamental change in ownership of the Company occurs. The bond has an initial conversion price of \$41.28, or a conversion rate of 24.2248 shares, which will be adjustable depending on the average closing prices for the applicable period. The maximum conversion rate is 38.7597 shares.

The Company has entered into fixed to floating interest rate swaps for \$3.9 billion of its long-term debt. In 2006, in conjunction with the new issuance of \$1.25 billion 5.87% Notes due 2036 and €1.0 billion Euro Notes (\$1.3 billion), the Company executed several fixed to floating interest rate swaps to convert the new fixed rate debt to be paid in 2016, 2021, and 2036 to variable rate debt. During 2004, the Company executed several fixed to floating interest rate swaps to convert \$700 million of the Company's fixed rate debt to be paid in 2023 and 2026 to variable rate debt. For the year ended December 31, 2006, the Company realized a net increase in interest expense of \$18 million as a result of the higher floating rates obtained in the swap agreements. For the year ended December 31, 2005, the Company recognized a net reduction in interest expense of \$54 million that reflects the benefit of the lower floating rates obtained in the swap agreements.

In November 2006, in connection with the early retirement of its outstanding \$2.5 billion 5.75% Notes due 2011, the Company terminated the remaining \$2.0 billion notional amount of its 2011 fixed to floating interest rate swap agreements and incurred a pre-tax loss of \$62 million. In April 2005, in connection with the early redemption of its \$2.5 billion Notes due 2006, the Company terminated \$2 billion notional amount of its 2006 fixed-to-floating interest rate swap agreements and incurred a pre-tax loss of \$28 million. In June 2005, the Company terminated \$500 million notional amount of its 2011 fixed-to-floating interest rate swap agreements related to its \$2.5 billion Notes due 2011, and incurred a pre-tax loss of \$23 million. This loss was being amortized to interest expense with \$3 million and \$2 million being recognized in 2006 and 2005, respectively. The remaining loss of \$18 million, together with the \$62 million loss incurred from the unwind of \$2.0 billion swap was fully recognized in 2006. In September 2005, the Company terminated \$350 million notional amount of its 2026 fixed-to-floating interest rate swap agreements related to its \$350 million Debentures due 2026 at a gain of \$39 million. This gain will be recognized against interest expense over the remaining life of the Debentures due 2026, of which approximately \$1 million was recognized in 2006 and 2005.

Cash payments for interest, including payments due to interest rate swaps, were \$682 million, \$598 million and \$354 million in 2006, 2005 and 2004, respectively. The Company's cash receipts from interest rate swaps were \$205 million, \$275 million and \$298 million in 2006, 2005 and 2004, respectively, and were excluded from cash payments for interest.

Dollars in Millions	Payments due by period						
	Total	2007	2008	2009	2010	2011	Later years
Long-Term Debt ⁽²⁾	\$7,248	\$ —	\$1,735	\$ —	\$1,329	\$ —	\$4,184

⁽²⁾ 2007 obligations are included in short-term borrowings on the Company's consolidated balance sheet at December 31, 2006 and all balances approximate the outstanding nominal long-term debt values. The Company's convertible debenture is included as due for payment in 2008, as it contains a 2008 put and call feature as described above.

At December 31, 2006, the Company had provided a total of \$165 million financial guarantees in the form of stand-by letters of credit and performance bonds. The stand-by letters of credit are with insurance companies in support of third-party liability programs. The performance bonds have been issued to support a range of ongoing operating activities including sale of Company products to hospitals and foreign ministries of health, bonds for customs, duties and value added tax, and guarantees related to miscellaneous legal actions. A significant majority of the Company's outstanding financial guarantees will expire within the year and are not expected to be funded.

Note 15 Stockholders' Equity

Changes in common shares, treasury stock, capital in excess of par value of stock, and restricted stock were as follows:

Dollars and Shares in Millions	Common Shares Issued	Treasury Shares	Cost of Treasury Stock	Capital in Excess of Par Value of Stock	Restricted Stock
Balance at January 1, 2004	2,201	261	\$ (11,440)	\$ 2,477	\$ (55)
Issued pursuant to stock plans and options	1	(6)	137	12	(32)
Amortization of restricted stock	—	—	—	—	24
Lapses and forfeitures of restricted stock	—	—	(8)	2	6
Balance at December 31, 2004	2,202	255	(11,311)	2,491	(57)
Issued pursuant to stock plans and options	3	(7)	148	36	(40)
Amortization of restricted stock	—	—	—	—	22
Lapses and forfeitures of restricted stock	—	—	(5)	1	4
Balance at December 31, 2005	2,205	248	(11,168)	2,528	(71)
Issued pursuant to stock plans and options	—	(11)	262	67	(81)
Amortization of restricted stock	—	—	—	33	1
Lapses and forfeitures of restricted stock	—	1	(21)	(2)	23
Balance at December 31, 2006	2,205	238	\$ (10,927)	\$ 2,626	\$ (128)

Each share of the Company's preferred stock is convertible into 16.96 shares of common stock and is callable at the Company's option. The reductions in the number of issued shares of preferred stock in 2006, 2005, and 2004 were due to conversions into shares of common stock.

Dividends declared per common share were \$1.12 in 2006, \$1.12 in 2005 and \$1.12 in 2004.

The accumulated balances related to each component of other comprehensive income/(loss), net of taxes, were as follows:

Dollars in Millions	Foreign Currency Translation	Deferred (Income)/Loss on Effective Hedges	Minimum Pension Liability Adjustment	Deferred Charges on Pension and Other Postretirement Benefits	Available for Sale Securities	Accumulated Other Comprehensive Income/(Loss)
Balance at January 1, 2004	\$ (491)	\$ (258)	\$ (130)	\$ —	\$ 24	\$ (855)
Other comprehensive income/(loss)	208	(51)	(93)	—	(1)	63
Balance at December 31, 2004	(283)	(309)	(223)	—	23	(792)
Other comprehensive income/(loss)	(270)	325	(6)	—	(22)	27
Balance at December 31, 2005	(553)	16	(229)	—	1	(765)
Other comprehensive income/(loss)	129	(39)	82	—	12	184
Adjustments on adoption of SFAS No. 158	—	—	147	(1,211)	—	(1,064)
Balance at December 31, 2006	\$ (424)	\$ (23)	\$ —	\$ (1,211)	\$ 13	\$ (1,645)

Note 16 Employee Stock Benefit Plans

Employee Stock Plans

Under the Company's 2002 Stock Incentive Plan, executive officers and key employees may be granted options to purchase the Company's common stock at no less than 100% of the market price on the date the option is granted. Options generally become exercisable in installments of 25% per year on each of the first through the fourth anniversaries of the grant date and have a maximum term of 10 years. Generally, the Company issues shares for the stock option exercise from treasury stock. Additionally, the plan provides for the granting of stock appreciation rights whereby the grantee may surrender exercisable rights and receive common stock and/or cash measured by the excess of the market price of the common stock over the option exercise price.

Under the terms of the 2002 Stock Incentive Plan, authorized shares include 0.9% of the outstanding shares per year through 2007, as well as the number of shares tendered in a prior year to pay the purchase price of options and the number of shares previously utilized to satisfy withholding tax obligations upon exercise. Shares that were available for grant in a prior year but were not granted in such year and shares that were cancelled, forfeited or expired are also available for future grant.

The 2002 Stock Incentive Plan provides for the granting of common stock to key employees, subject to restrictions as to continuous employment. Restrictions generally expire over a four-year period from date of grant. Compensation expense is recognized over the restricted period. At December 31, 2006 and 2005, there were 6.9 million and 4.2 million shares of restricted stock and restricted stock units outstanding under the plan, respectively. For the years ended December 31, 2006, 2005 and 2004, approximately 4.3 million, 1.8 million and 1.2 million shares, respectively, of restricted stock and restricted stock units were granted with a weighted average fair value of \$23.45, \$24.61 and \$27.64 per common share, respectively.

The 2002 Stock Incentive Plan also incorporates the Company's long-term performance awards. These awards, which are delivered in the form of a target number of performance shares, have a three-year cycle. For 2006 to 2008, the awards will be based 50% on cumulative earnings per share and 50% on cumulative sales, with the ultimate payout modified by the Company's total stockholder return versus the 11 companies in its proxy peer group. If threshold targets are not met for the performance period, no payment will be made under the long-term performance award plan. Maximum performance for all three measures will result in a maximum payout of 253% of target. At December 31, 2006 and 2005, there were 1.8 million and 1.8 million performance shares outstanding under the plan, respectively. In 2006, 2005 and 2004, 0.6 million, 1.1 million and 0.5 million performance shares were granted, respectively, with a fair value of \$20.00, \$25.45 and \$28.11 per common share, respectively.

Under the TeamShare Stock Option Plan, which terminated on January 3, 2005, full-time employees, excluding key executives, were granted options to purchase the Company's common stock at the market price on the date the options were granted. The Company authorized 66 million shares for issuance under the plan. Individual grants generally became exercisable evenly on the third, fourth and fifth anniversary of the grant date and have a maximum term of 10 years. Options on 35.5 million shares have been exercised under the plan as of December 31, 2006.

The Company's results of operations for the year ended December 31, 2006 reflect the impact of SFAS No. 123(R), which includes the impact of the expensing of stock options. The Company has elected the alternative method as provided in FSP No. 123(R)-3 in determining the Company's pool of excess tax benefits. The results of operations for the years ended December 31, 2005 and 2004 were not restated to reflect the impact of expensing of stock options and are prepared in accordance with APB No. 25. The following table summarizes stock-based compensation expense, net of tax, related to employee stock options, restricted stock, and long-term performance awards for the years ended December 31, 2006, 2005 and 2004:

Dollars in Millions	Years Ended December 31,		
	2006	2005	2004
Cost of products sold	\$ 11	\$ —	\$ —
Marketing, selling and administrative	67	31	30
Research and development	34	—	—
Total stock-based compensation expense	112	31	30
Deferred tax benefit	39	11	11
Stock-based compensation, net of tax	\$ 73	\$ 20	\$ 19

The table below reflects pro forma net income and diluted net income per share for the years ended December 31, 2005 and 2004:

Dollars in Millions Except Per Share Data	Year Ended December 31,	
	2005	2004
Net Earnings:		
As reported	\$ 3,000	\$ 2,388
Total stock-based employee compensation expense, included in reported net earnings, net of related tax effects	20	19
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(112)	(138)
Pro forma	\$ 2,908	\$ 2,269
Basic Earnings per Share:		
As reported	\$ 1.53	\$ 1.23
Pro forma	1.49	1.17
Diluted Earnings per Share:		
As reported	\$ 1.52	\$ 1.21
Pro forma	1.48	1.15

There were no costs related to stock-based compensation that were capitalized during the period.

A summary of option activities were as follows:

Shares in Millions	Shares of Common Stock		Weighted-Average Exercise Price of Shares
	Available for Option Award	Issued Under Plan	
Balance at January 1, 2004	29	161	\$ 39.24
Authorized	18	—	—
Granted	(20)	20	27.88
Exercised	—	(7)	14.56
Lapsed	11	(11)	40.69
Balance at December 31, 2004	38	163	38.87
Authorized	18	—	—
Granted	(20)	20	25.37
Exercised	—	(9)	16.26
Lapsed	10	(10)	37.67
Balance at December 31, 2005	46	164	38.45
Authorized	18	—	—
Granted	(16)	16	23.18
Exercised	—	(8)	21.00
Lapsed	9	(9)	33.53
Balance at December 31, 2006	57	163	38.16

The weighted-average grant-date fair value of options granted by the Company during the twelve months ended December 31, 2006, 2005 and 2004 was \$4.74, \$5.49 and \$5.91, respectively. The total intrinsic value of options exercised for the twelve month periods ended December 31, 2006, 2005 and 2004 was \$17 million, \$69 million and \$71 million, respectively. During the twelve months ended December 31, 2006, 2005 and 2004, the Company received \$167 million, \$137 million and \$89 million in cash proceeds from the exercise of its stock options. As of December 31, 2006, there was \$91 million of total unrecognized compensation cost related to stock options and is expected to be recognized over a weighted-average period of 2.7 years.

The following tables summarize information concerning the Company's stock compensation plans and currently outstanding and exercisable options:

Shares in Millions	Number of securities to be issued upon exercise of outstanding options and rights (a)	Weighted-average exercise price of outstanding options and rights (b)	Number of securities remaining available for future issuance under equity compensation plans excluding securities reflected in column (a) (c)
Plan Category			
Equity compensation plans approved by security holders	143	\$ 37.51	44
Equity compensation plans not approved by security holders ⁽¹⁾	20	42.94	13
	<u>163</u>	<u>38.16</u>	<u>57</u>

(1) Shares under this plan are no longer being issued.

The following table summarizes significant ranges of outstanding and exercisable options as of December 31, 2006 (shares in millions):

Range of Exercise Prices	Number Outstanding	Options Outstanding			Options Exercisable			
		Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value (in millions)	Number Exercisable	Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value (in millions)
\$20 - \$30	82	7.07	\$ 25.70	\$ 114	44	6.15	\$ 26.35	\$ 48
\$30 - \$40	9	.19	32.30	—	8	.19	32.30	—
\$40 - \$50	41	2.81	47.03	—	41	2.81	47.04	—
\$50 - \$60	13	3.99	58.13	—	12	3.97	57.97	—
\$60 and up	18	2.48	63.31	—	18	2.48	63.29	—
	<u>163</u>	4.88	38.16	<u>\$ 114</u>	<u>123</u>	3.88	42.03	<u>\$ 48</u>

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on the Company's average stock price of \$26.27 on December 29, 2006, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable as of December 31, 2006 was 20 million. As of December 31, 2005, 113 million outstanding options were exercisable, and the weighted-average exercise price was \$42.23.

At December 31, 2006, 306 million shares of common stock were reserved for issuance pursuant to stock plans, options and conversions of preferred stock.

Stock Option Valuation

The fair value of employee stock options granted in 2006 were estimated on the date of the grant and prior to January 1, 2006, were estimated using a weighted-average estimated per option value granted, using the Black-Scholes option pricing model with the following assumptions:

	2006	2005	2004
Expected volatility	26.7%	29.4%	30.0%
Risk-free interest rate	4.6%	4.4%	3.5%
Dividend yield	4.8%	4.6%	4.4%
Expected life	6.3 yrs	7.0 yrs	7.0 yrs

The Company derived the expected volatility assumption required in the Black-Scholes model by calculating a 10-year historical volatility and weighting that equally against the derived implied volatility, consistent with SFAS No. 123(R) and SAB No. 107. Prior to 2006, the Company had used its historical stock price volatility in accordance with SFAS No. 123 for purposes of its pro forma information. The selection of the blended historical and implied volatility approach was based on the Company's assessment that this calculation of expected volatility is more representative of future stock price trends than using only historical volatility.

The risk-free interest rate assumption is based upon the U.S. Treasury yield curve in effect at the time of grant. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the lattice-binomial model. The expected life of employee stock options is impacted by all of the underlying assumptions and calibration of the Company's model. The lattice-binomial model assumes that employees' exercise behavior is a function of the option's remaining vested life and the extent to which the option is in-the-money. The lattice-binomial model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and cancellations on all past option grants made by the Company.

Prior to 2006, the Company used an option-pricing model to indirectly estimate the expected life of the stock options. The expected life and expected volatility of the stock options were based upon historical and other economic data trended into the future. Forfeitures of employee stock options were accounted for on an as-incurred basis.

As stock-based compensation expense recognized in the consolidated statement of earnings for the twelve months ended December 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience. In the Company's pro forma information required under SFAS No. 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

Restricted Stock

The fair value of nonvested shares of the Company's common stock is determined based on the average trading price of the Company's common stock on the grant date.

Restricted share activities were as follows:

Shares in Thousands	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested shares at January 1, 2004	2,308	\$ 36.34
Granted	1,244	27.64
Vested	(398)	43.39
Forfeited	(209)	35.58
Nonvested shares at December 31, 2004	2,945	31.12
Granted	1,786	24.61
Vested	(375)	38.56
Forfeited	(194)	31.37
Nonvested shares at December 31, 2005	4,162	27.36
Granted	4,295	23.45
Vested	(645)	32.48
Forfeited	(921)	26.64
Nonvested shares at December 31, 2006	6,891	24.58

As of December 31, 2006 and 2005, there was \$126 million and \$75 million, respectively, of total unrecognized compensation cost related to nonvested restricted stock and restricted stock units. That cost is expected to be recognized over a weighted-average period of 2.75 years for the balance at December 31, 2006 and 3.5 years for the balance at December 31, 2005. The total fair value of shares and share units that vested during the twelve months ended December 31, 2006, 2005 and 2004 was \$21 million, \$14 million and \$17 million, respectively.

Long-Term Performance Awards

Prior to the adoption of SFAS No. 123(R), compensation expense related to long-term performance awards was determined based on the market price of the Company's stock at the time of the award applied to the expected number of shares contingently issuable (up to 100%), and was amortized over the three-year performance cycle. Upon adoption of SFAS No. 123(R), the fair value of each long-term performance award was estimated on the date of grant using a Monte Carlo simulation model instead of the grant date market price used previously.

The Company changed its valuation technique based on further clarification provided in SFAS No. 123(R) and the fact that long-term performance awards contain a market condition and performance conditions that affect factors other than vesting (i.e., variable number of shares to be awarded), which should be reflected in the grant date fair value of an award. The Monte Carlo simulation model utilizes multiple input variables that determine the probability of satisfying each market condition stipulated in the award grant and calculates the fair market value for the long-term performance awards. The valuation model used the following assumptions:

Grant Year	Grant Date	Weighted-Average Expected Volatility	Expected Dividend Yield	Risk Free Interest Rate
2006	3/7/2006	20.4%	4.9%	4.4%

Weighted-average expected volatility is based on the three year historical volatility levels on the Company's common stock. Expected dividend yield is based on historical dividend payments. Risk free interest rate reflects the yield on 5-year zero coupon U.S. Treasury bonds, based on the performance shares' contractual term. The fair value of the 2006 long-term performance awards is amortized over the performance period of the award.

Shares in Thousands	Performance Cycle Measurement Date	Long-Term Performance Shares Outstanding	
		Weighted-Average Grant Date Fair Value	December 31, 2006
3/2/04	12/31/06	\$ 28.11	417
3/1/05	12/31/07	25.45	894
3/7/06	12/31/08	20.00	461

At December 31, 2006 and 2005, there was \$2 million and \$8 million, respectively, of total unrecognized compensation cost related to the performance share plan, which is expected to be recognized over a weighted-average period of 2.0 years and 1.7 years, respectively.

Accuracy of Fair Value Estimates

The Company's determination of fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because the Company's employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management's opinion, the existing valuation models may not provide an accurate measure of the fair value of the Company's employee stock options. Although the fair value of employee stock options is determined in accordance with SFAS No. 123(R) and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

The Company adopted SFAS No. 123(R), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors based on estimated fair values. SFAS No. 123(R) supersedes the Company's previous accounting under APB No. 25 for periods beginning January 1, 2006. In March 2005, the SEC issued SAB No. 107 relating to SFAS No. 123(R). The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, and has elected the alternative method as provided in FSP No. 123(R)-3 in determining the Company's pool of excess tax benefits. The Company's consolidated financial statements for the year ended December 31, 2006 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Stock-based compensation expense recognized under SFAS No. 123(R) for the year ended December 31, 2006 was \$112 million (\$73 million, net of tax) or \$0.04 per share, with a corresponding amount recorded in additional paid-in capital within stockholders' equity. Additionally, \$10 million related to performance awards was reclassified from liabilities to stockholders' equity in connection with the adoption of SFAS No. 123(R).

Note 17 Financial Instruments

The Company is exposed to market risk due to changes in currency exchange rates and interest rates. To reduce that risk, the Company enters into certain derivative financial instruments, when available on a cost-effective basis, to hedge its underlying economic exposure. These instruments are managed on a consolidated basis to efficiently net exposures and thus take advantage of any natural offsets. Derivative financial instruments are not used for speculative purposes.

The Company's primary net foreign currency translation exposures are the Euro, Japanese yen, Mexican peso, Chinese renminbi, and Canadian dollar.

The Company utilizes foreign currency contracts to hedge anticipated transactions, primarily intercompany transactions, on certain foreign currencies and designates these derivative instruments as foreign currency cash flow hedges when appropriate. The notional amounts of the Company's foreign exchange derivative contracts at December 31, 2006 and 2005 were \$1,585 million and \$2,296 million, respectively. For these derivatives, in which the majority qualify as hedges of future anticipated cash flows, the effective portion of changes in fair value is temporarily deferred in accumulated OCI and then recognized in earnings when the hedged item affects earnings.

During 2006, 2005 and 2004, the Company reclassified deferred losses of \$18 million, \$130 million and \$234 million, respectively, from accumulated OCI to earnings, the majority of which was classified as cost of products sold. As of December 31, 2006, the balance of deferred net after-tax losses of foreign exchange forward contracts included in accumulated OCI was \$22 million, of which a net after-tax loss of \$25 million is estimated to be reclassified into earnings within the next 12 months.

SFAS No. 133 requires that the Company perform periodic assessments of hedge effectiveness. These assessments determine whether derivatives designated as qualifying hedges continue to be highly effective in offsetting changes in the cash flows of hedged items. Any ineffective portion of fair value can no longer be deferred in accumulated OCI and is included in current period earnings. For the years ended December 31, 2006 and 2005, the impact of hedge ineffectiveness on earnings was not significant. Additionally, for the years ended December 31, 2006 and 2005 the impact of discontinued hedges were a loss of \$10 million and a gain of \$2 million, respectively. Furthermore, the Company uses foreign exchange forward contracts to offset its exposure to certain currency

assets and liabilities. These foreign exchange forward contracts are not designated as hedges and, therefore, changes in the fair value of these derivatives are recognized in earnings as they occur. In 2006 and 2005, the amounts recognized in earnings related to foreign exchange forward contracts that did not qualify for hedge accounting treatment were not significant.

The fair value of forward contracts was a net liability of \$33 million at December 31, 2006, of which \$18 million was recorded as a non-current asset and \$51 million was recorded as a current liability. The fair value of forward contracts was a net asset of \$53 million at December 31, 2005, of which \$94 million was recorded as a non-current asset and \$41 million was recorded as a current liability. The fair value of all foreign exchange contracts is based on year-end currency rates (and the Black-Scholes model in the case of option contracts).

The Company had exposures to net foreign currency denominated assets and liabilities of approximately \$1.6 billion and \$2.5 billion at December 31, 2006 and 2005, respectively, primarily in Mexico, Japan, the UK, China, Australia and Canada. The reduction in net exposure was primarily due to the issuance of €1 billion Euro (\$1.3 billion) Notes in 2006. For additional information, see Note 14 "Short-Term Borrowings and Long-Term Debt."

In addition to the foreign exchange hedge contracts noted above, the Company utilizes forward contracts to hedge foreign currency denominated monetary assets and liabilities. The primary objective of these forward contracts is to protect the U.S. dollar value of foreign currency denominated monetary assets and liabilities from the effects of volatility in foreign exchange rates that might occur prior to their receipt or settlement in U.S. dollars. These foreign currency denominated monetary assets and liabilities are primarily denominated in Euro. The forward contracts are not designated as hedges and are marked to market through other income/expense. The notional and fair value amount of purchased foreign exchange forward contracts was \$24 million and a \$1 million asset, respectively, at December 31, 2006, and was \$142 million and a \$2 million liability, respectively, at December 31, 2005. The notional and fair value amount of sold foreign exchange forward contracts was \$22 million and a \$1 million liability, respectively, at December 31, 2006, and was \$47 million and a \$1 million asset, respectively, at December 31, 2005.

The Company also uses non U.S. dollar borrowings and, to a lesser extent, forward contracts, to hedge the foreign currency exposures of the Company's net investment in certain foreign affiliates. These non U.S. dollar borrowings and forward contracts are designated as hedges of net investments. The effective portion of foreign exchange gains or losses on these hedges is recorded as part of the foreign currency translation component of OCI. At December 31, 2006 and 2005, \$17 million in after tax losses and \$12 million in after tax gains, respectively, were recorded in the foreign currency translation component of OCI.

The Company uses derivative instruments as part of its interest rate risk management strategy. The derivative instruments used comprised principally of fixed to floating rate interest rate swaps, which are subject to fair-value hedge accounting treatment. In November 2006, in connection with the funding of the retirement of the 2011 fixed rate debt, the Company executed several fixed to floating interest rate swaps to convert \$1.3 billion and €1 billion Euro (\$1.3 billion) of the Company's newly issued fixed rate debt to be paid in 2016, 2021 and 2036 to variable rate debt. During 2004, the Company executed several fixed to floating interest rate swaps to convert \$700 million of the Company's fixed rate debt to be paid in 2023 and 2026 to variable rate debt. The total notional amount of outstanding interest rate swaps were \$2.6 billion and €1 billion Euro (\$1.3 billion) as of December 31, 2006 and \$3.4 billion as of December 31, 2005. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Company recognized a net increase in interest expense of \$18 million in 2006, and a net reduction in interest expense of \$54 million and \$151 million in 2005 and 2004, respectively, from the impact of interest rate swaps.

The swap contracts as well as the underlying debt being hedged are recorded at fair value, which resulted in an increase in non-current assets of \$7 million and current liabilities of \$57 million, and a reduction in long-term debt of \$50 million at December 31, 2006; and an increase in non-current assets of \$21 million, current liabilities of \$51 million and a reduction in long-term debt of \$30 million at December 31, 2005. Swap contracts are generally held to maturity and are intended to create an appropriate balance of fixed and floating rate debt for the Company. Swap contracts that qualify as fair value hedges and that are terminated prior to their maturity dates are reported as part of the carrying value of the underlying debt and are amortized to earnings over the remaining life of the debt. Swap contracts that qualify as cash flow hedges and that are terminated are reported in accumulated OCI and amortized to earnings over the remaining life of the debt. The following tables summarize the new and terminated interest rate swaps for 2006 and 2005:

Dollars/Euro in Millions	Year of Transaction	Notional Amount of Underlying Debt
Interest Rate Contracts:		
Swaps associated with 4.375% €500 EUR Notes due 2016	2006	\$ 641
Swaps associated with 4.625% €500 EUR Notes due 2021	2006	641
Swaps associated with 5.875% Notes due 2036	2006	1,250

Terminated Swap Contracts

Interest Rate Contracts	Year of Termination	Notional Amount of Underlying Debt	Total Pre-Tax Deferred Gain/(Loss)	2006 Pre-Tax Income/(Expense) Recognized	2005 Pre-Tax Income/(Expense) Recognized
Dollars in Millions					
Interest rate swap lock associated with 5.75% Notes due 2011 ⁽¹⁾	2001	\$2,500	\$ (58)	\$ (37)	\$ (5)
Interest Rate Swap Lock associated with 4.75% Notes due 2006	2001	2,000	(48)	—	(15)
Swaps associated with 4.75% Notes due 2006 ⁽¹⁾	2005	2,000	(13)	—	(13)
Swaps associated with 5.75% Notes due 2011 ⁽¹⁾	2005	500	(23)	(21)	(2)
Swaps associated with 6.8% Notes due 2026	2005	350	39	1	—
Swaps associated with 5.75% Notes due 2011 ⁽¹⁾	2006	2,000	(62)	(62)	—
			\$ (165)	\$ (119)	\$ (35)

(1) The underlying 2011 and 2006 Notes were extinguished in 2006 and 2005, respectively.

The carrying amount of the Company's other financial instruments, which includes cash, cash equivalents, marketable securities, accounts receivable and accounts payable, approximates their fair value at December 31, 2006 and 2005. For long-term debt the difference between the fair value and carrying value is not material.

Note 18 Segment Information

The Company is organized in three reportable segments—Pharmaceuticals, Nutritionals and Other Health Care. The Pharmaceuticals segment is comprised of the global pharmaceutical and international consumer medicines businesses. The Nutritionals segment consists of Mead Johnson, primarily an infant formula business and children's nutritional business. The Other Health Care segment consists of the ConvaTec, Medical Imaging and Consumer Medicines businesses. In the third quarter of 2005, the Company completed the sale of its Consumer Medicines business. For additional information on the sale of Consumer Medicines, see Note 4 "Acquisitions and Divestitures."

The Company's products are sold principally to the wholesale and retail trade, both nationally and internationally. Certain products are also sold to other drug manufacturers, hospitals, clinics, government agencies and the medical profession. Three wholesalers accounted for approximately 18%, 17% and 10%, respectively, of the Company's total net sales in 2006. In 2005, sales to these wholesalers accounted for 20%, 19% and 11%, respectively, of the Company's total net sales. In 2004, the same three wholesalers each accounted for approximately 19%, 17% and 10%, respectively, of the Company's total net sales. These sales were concentrated in the Pharmaceuticals segment.

Dollars in Millions	Net Sales			Earnings Before Minority Interest and Income Taxes			Year-end Assets	
	2006	2005	2004	2006	2005	2004	2006	2005
Pharmaceuticals	\$ 13,861	\$ 15,254	\$ 15,564	\$ 2,559	\$ 3,732	\$ 4,334	\$ 11,768	\$ 11,671
Nutritionals	2,347	2,205	2,001	696	677	610	1,167	1,088
Other Health Care	1,706	1,748	1,815	517	469	510	1,124	1,180
Health Care Group	4,053	3,953	3,816	1,213	1,146	1,120	2,291	2,268
Total segments	17,914	19,207	19,380	3,772	4,878	5,454	14,059	13,939
Corporate/Other	—	—	—	(1,137)	(362)	(1,036)	11,516	14,199
Total	\$ 17,914	\$ 19,207	\$ 19,380	\$ 2,635	\$ 4,516	\$ 4,418	\$ 25,575	\$ 28,138

Corporate/Other consists principally of interest income, interest expense, certain administrative expenses and allocations to the business segments of certain corporate programs, litigation expense, debt retirement costs, gain on sale of businesses and product asset, deferred income recognized from collaboration agreement and restructuring charges. Corporate/Other assets include cash and cash equivalents, marketable securities, goodwill, assets of OTN held available for sale at December 31, 2004 and sold in 2005 and certain other assets.

Dollars in Millions	Capital Expenditures			Depreciation		
	2006	2005	2004	2006	2005	2004
Pharmaceuticals	\$ 543	\$ 554	\$ 455	\$ 460	\$ 477	\$ 474
Nutritionals	65	65	55	41	38	48
Other Health Care	28	30	27	21	25	22
Health Care Group	93	95	82	62	63	70
Total segments	636	649	537	522	540	544
Corporate/Other	44	44	49	42	37	49
Total	\$ 680	\$ 693	\$ 586	\$ 564	\$ 577	\$ 593

Geographic Areas

Dollars in Millions	Net Sales			Year-end Assets	
	2006	2005	2004	2006	2005
United States	\$ 9,729	\$ 10,461	\$ 10,613	\$ 16,942	\$ 20,579
Europe, Middle East and Africa	4,544	5,136	5,470	5,032	4,779
Other Western Hemisphere	1,615	1,592	1,425	2,237	1,556
Pacific	2,026	2,018	1,872	1,364	1,224
Total	\$ 17,914	\$ 19,207	\$ 19,380	\$ 25,575	\$ 28,138

The change in year-end assets in the U.S. in 2006 from 2005 was primarily due to a decrease in cash, cash equivalents and marketable securities resulting from the reinvestment in 2006 of foreign dividends received in 2005 pursuant to the repatriation of earnings to the U.S. under AJCA.

Note 19 Leases

Minimum rental commitments under all non-cancelable operating leases, primarily real estate and motor vehicles, in effect at December 31, 2006, were as follows:

Years Ending December 31,	Dollars in Millions
2007	\$ 141
2008	120
2009	97
2010	70
2011	63
Later years	223
Total minimum payments	714
Less total minimum sublease rentals	52
Net minimum rental commitments	\$ 662

Operating lease rental expense (net of sublease rental income of \$21 million in 2006, \$15 million in 2005 and \$13 million in 2004) was \$149 million in 2006, \$150 million in 2005 and \$149 million in 2004.

In December 2006, the Company completed the sale and leaseback of several administrative facilities in New Jersey for \$283 million. The resulting pre-tax gain from the transaction of \$154 million was deferred and will reduce future lease rental costs over the lease periods ranging from 8 to 12 years.

Note 20 Pension and Other Postretirement Benefit Plans

The Company and certain of its subsidiaries have defined benefit pension plans, defined contribution plans, and termination indemnity plans for regular full-time employees. The principal pension plan is the Bristol-Myers Squibb Retirement Income Plan in the U.S. The funding policy is to contribute amounts to provide for current service and to fund past service liability. Plan benefits are based primarily on the participant's years of credited service and compensation. Plan assets consist principally of equity and fixed-income securities.

The Company also provides comprehensive medical and group life benefits for substantially all U.S. retirees who elect to participate in its comprehensive medical and group life plans. The medical plan is contributory. Contributions are adjusted periodically and vary by date of retirement and the original retiring Company. The life insurance plan is noncontributory. Plan assets consist principally of equity and fixed-income securities. Similar plans exist for employees in certain countries outside of the U.S.

The Company adopted SFAS No. 158 in the fiscal year ended December 31, 2006, resulting in a \$1,064 million reduction of accumulated OCI in stockholders' equity, a \$767 million reduction in total assets and a \$297 million increase in total liabilities. The impact of the adoption is summarized as follows:

Dollars in Millions	SFAS No. 158 Adjustments				Post SFAS No. 158
	Pre SFAS No. 158	Pre-tax	Tax	Net	
Current Assets:					
Deferred income taxes	\$ 573	\$ —	\$ 76	\$ 76	\$ 649
Non-Current Assets:					
Deferred income taxes	2,139	—	438	438	2,577
Prepaid pension	1,324	(1,324)	—	(1,324)	—
Other assets	299	43	—	43	342
Current Liabilities:					
Accrued expenses	2,251	81	—	81	2,332
U.S. and foreign income taxes payable	445	—	(1)	(1)	444
Non-Current Liabilities:					
Other Liabilities	327	269	(52)	217	544
Stockholders' Equity:					
Accumulated other comprehensive loss	(581)	(1,631)	567	(1,064)	(1,645)

Cost of the Company's deferred benefits and postretirement benefit plans included the following components:

Dollars in Millions	Pension Benefits			Other Benefits ^(a)		
	2006	2005	2004	2006	2005	2004
Service cost — benefits earned during the year	\$ 238	\$ 223	\$ 180	\$ 9	\$ 9	\$ 8
Interest cost on projected benefit obligation	326	314	295	34	36	37
Expected return on plan assets	(410)	(361)	(355)	(22)	(20)	(18)
Net amortization and deferral	179	216	157	1	3	—
Net periodic benefit cost	333	392	277	22	28	27
Curtailments and settlements	(1)	—	(1)	—	—	—
Total net periodic benefit cost	\$ 332	\$ 392	\$ 276	\$ 22	\$ 28	\$ 27

^(a) The Company has recognized the impact of the Medicare Prescription Drug Improvement and Modernization Act of 2003 in 2006, 2005 and 2004, and in accordance with FSP No. 106-2, recorded \$11 million, \$11 million and \$8 million in 2006, 2005 and 2004, respectively, as a reduction in net periodic benefit costs.

The estimated net actuarial loss and prior service cost that will be amortized from accumulated OCI into net periodic benefit cost in 2007 are:

Dollars in Millions	Pension Benefits	Other Benefits
Amortization of net actuarial loss	\$ 133	\$ 6
Amortization of prior service cost	11	(3)
	\$ 144	\$ 3

Changes in benefit obligations, plan assets, funded status and amounts recognized on the balance sheet as of and for the years ended December 31, 2006 and 2005, for the Company's defined benefit and postretirement benefit plans, were as follows:

Dollars in Millions	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Benefit obligation at beginning of year	\$ 5,918	\$ 5,481	\$ 643	\$ 646
Service cost—benefits earned during the year	238	223	9	9
Interest cost on projected benefit obligation	326	314	34	36
Plan participants' contributions	3	3	12	8
Curtailments and settlements	(2)	(2)	—	—
Actuarial losses/(gains)	10	400	27	17
Plan amendments	7	—	—	—
Retiree drug subsidy received	—	—	6	—
Benefits paid	(432)	(386)	(81)	(73)
Exchange rate (gains)/losses	118	(115)	1	—
Benefit obligation at end of year	\$ 6,186	\$ 5,918	\$ 651	\$ 643
Fair value of plan assets at beginning of year	\$ 5,017	\$ 4,602	\$ 253	\$ 230
Actual return on plan assets	649	469	38	23
Employer contribution	325	423	63	65
Plan participants' contributions	3	3	12	8
Settlements	—	(1)	—	—
Retiree drug subsidy received	—	—	6	—
Benefits paid	(432)	(386)	(81)	(73)
Exchange rate (losses)/gains	96	(93)	—	—
Fair value of plan assets at end of year	\$ 5,658	\$ 5,017	\$ 291	\$ 253
Funded status	\$ (528)	\$ (901)	\$ (360)	\$ (390)
Unamortized net obligation at adoption	—	2	—	—
Unrecognized prior service cost	—	61	—	(27)
Unrecognized net actuarial loss	—	2,067	—	108
Net amount recognized	\$ (528)	\$ 1,229	\$ (360)	\$ (309)

Dollars in Millions	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Amounts recognized in the balance sheet consist of:				
Prepaid pension (prepaid benefit cost)	\$ —	\$ 1,324	\$ —	\$ —
Other assets	45	2	—	—
Accrued expenses	(25)	—	(56)	—
Pension and other postretirement liabilities (accrued benefit cost)	(548)	(423)	(304)	(309)
Accumulated other comprehensive loss	—	326	—	—
Net amount recognized	\$ (528)	\$ 1,229	\$ (360)	\$ (309)
Amounts recognized in accumulated other comprehensive loss				
Net actuarial loss	\$ 1,711	\$ —	\$ 117	\$ —
Net obligation at adoption	2	—	—	—
Prior service cost	55	—	(24)	—
	\$ 1,768	\$ —	\$ 93	\$ —

Several plans had underfunded accrued benefit obligations that exceeded their accrued benefit liabilities at December 31, 2006 and 2005. Additional minimum liabilities were established to increase the accrued benefit liabilities to the values of the underfunded accrued benefit obligations. The additional minimum liabilities totaled \$232 million at December 31, 2006 prior to the adoption of SFAS No. 158, which were for a U.S. unfunded benefit equalization plan and several international plans. These liabilities were reversed upon the adoption of SFAS No. 158. The additional minimum liabilities totaled \$328 million at December 31, 2005, which were offset by intangible assets of \$2 million and charges to accumulated OCI included in stockholders' equity of \$326 million.

The accumulated benefit obligation for all defined benefit pension plans was \$5,422 million and \$5,209 million at December 31, 2006 and 2005, respectively.

Information for pension plans with accumulated benefit obligations in excess of plan assets were as follows:

Dollars in Millions	December 31,	
	2006	2005
Projected benefit obligation	\$ 1,328	\$ 1,343
Accumulated benefit obligation	1,137	1,148
Fair value of plan assets	795	748

This is attributable primarily to an unfunded U.S. benefit equalization plan and several plans in the international markets. The unfunded U.S. benefit equalization plan provides pension benefits for employees with compensation above IRS limits and cannot be funded in a tax-advantaged manner.

Additional information pertaining to the Company's pension and postretirement plans were as follows:

Dollars in Millions	Pension Benefits			Other Benefits		
	2006	2005	2004	2006	2005	2004
(Decrease)/Increase in minimum liability, including the impact of foreign currency fluctuations, included in other comprehensive income	\$ (96)	\$ (20)	\$ 153	\$ —	\$ —	\$ —

Weighted-average assumptions used to determine benefit obligations at December 31, were as follows:

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Discount rate	5.74%	5.49%	5.73%	5.49%
Rate of compensation increase	3.63%	3.60%	3.60%	3.61%

Weighted-average actuarial assumptions used to determine net periodic benefit cost for the years ended December 31, were as follows:

	Pension Benefits			Other Benefits		
	2006	2005	2004	2006	2005	2004
Discount rate	5.49%	5.57%	6.08%	5.49%	5.52%	6.01%
Expected long-term return on plan assets	8.39%	8.41%	8.73%	8.75%	8.75%	9.00%
Rate of compensation increase	3.60%	3.59%	3.57%	3.61%	3.59%	3.58%

At December 31, 2006, the Company's expected long-term rate of return on U.S. pension plan assets was 8.75%. The target asset allocation is 70% public equity (58% U.S., 12% international), 8% private equity and 22% fixed income. The 8.75% was approximated by applying expected returns of 9% on public equity, 15% on private equity and 6% on fixed income to the target allocation. The actual historical returns are also relevant. Annualized returns for periods ended December 31, 2006 were 9.3% for 10 years, 10.1% for 15 years and 10.5% for 20 years.

U.S. pension plan assets represented approximately 80% of total Company pension plan assets at December 31, 2005. The 8.39% disclosed above for total Company expected return on assets for 2006 is below the 8.75% for U.S. pension plans, due to the impact of international pension plans, which typically employ a less aggressive asset allocation.

An 8.75% expected return is disclosed for Other Benefits in 2006 as the relevant assets are invested in the same manner as U.S. pension plan assets and there are no international plan assets.

Assumed health care cost trend rates at December 31, were as follows:

	2006	2005	2004
Health care cost trend rate assumed for next year	9.87%	7.93%	8.93%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.49%	4.42%	4.51%
Year that the rate reaches the ultimate trend rate	2018	2012	2012

Assumed health care cost trend rates do have an effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

Dollars in Millions	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost	\$ 1	\$(1)
Effect on postretirement benefit obligation	25	(23)

The Company's asset allocation for pension and postretirement benefits at December 31, 2006 and 2005, were as follows:

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Public equity securities	67.2%	67.3%	69.2%	67.7%
Debt securities (including cash)	26.9	26.8	23.3	25.0
Private equity	5.6	5.6	7.2	7.1
Other	0.3	0.3	0.3	0.2
Total	100.0%	100.0%	100.0%	100.0%

The Company's investment strategy emphasizes equities in order to achieve high expected returns and, in the long run, low expense and low required cash contributions. For the U.S. pension plans, a target asset allocation of 70% public equity (58% U.S., 12% international), 8% private equity and 22% fixed income is maintained and cash flow (i.e., cash contributions, benefit payments) is used to rebalance back to the targets as necessary. Investments are very well diversified within each of the three major asset categories. About 40% of the U.S. equity is passively managed. Otherwise, all investments are actively managed.

Investment strategies for international pension plans are typically similar, although the asset allocations are usually more conservative.

Bristol-Myers Squibb Company common stock represents less than 1% of the plan assets at December 31, 2006 and 2005.

Assets for postretirement benefits are commingled with U.S. pension plan assets and, therefore, the investment strategy is identical to that described above for U.S. pension plans.

Contributions

Although no minimum contributions were required, the Company made cash contributions to the U.S. pension plans of \$235 million, \$318 million and \$225 million in 2006, 2005 and 2004, respectively. The Company also plans to make a cash contribution to the U.S. pension plans in 2007.

When contributions are made to the U.S. pension plans, the Company may make tax-deductible contributions to the 401(h) account for retiree medical benefits equal to a portion of the pension normal cost.

Contributions to the international pension plans were \$90 million, \$105 million and \$142 million in 2006, 2005 and 2004, respectively. Contributions to the international plans are now expected to be \$70 to \$90 million in 2007.

Estimated Future Benefit Payments

The following benefit payments for mainly the U.S. pension plans, which reflect expected future service, as appropriate, are expected to be paid:

Dollars in Millions	Pension Benefits	Other Benefits		
		Gross	Medicare Subsidy	Net
2007	\$ 309	\$ 67	\$ 8	\$ 59
2008	328	67	9	58
2009	386	67	10	57
2010	391	67	11	56
2011	408	66	11	55
Years 2012 – 2016	2,493	313	57	256

Savings Plan

The principal defined contribution plan is the Bristol-Myers Squibb Savings and Investment Program. The Company's contribution is based on employee contributions and the level of Company match. The Company's contributions to the plan were \$56 million in 2006, \$51 million in 2005 and \$53 million in 2004.

Termination Indemnity Plans

The Company operates in certain jurisdictions, primarily in Europe, which require the recording of statutory termination obligations. These obligations were assessed in accordance with Emerging Issues Task Force Issue No. 88-1, *Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*. The total pension liability recorded for these obligations was \$75 million at December 31, 2006 and \$68 million at December 31, 2005.

Note 21 Legal Proceedings and Contingencies

Various lawsuits, claims, proceedings and investigations are pending involving the Company and certain of its subsidiaries. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company records accruals for such contingencies when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. These matters involve antitrust, securities, patent infringement, pricing, sales and marketing practices, environmental, health and safety matters, consumer fraud, product liability and insurance coverage. The most significant of these matters are described below.

There can be no assurance that there will not be an increase in the scope of these matters or that any future lawsuits, claims, proceedings or investigations will not be material. Management continues to believe, as previously disclosed, that during the next few years, the aggregate impact, beyond current reserves, of these and other legal matters affecting the Company is reasonably likely to be material to the Company's results of operations and cash flows, and may be material to its financial condition and liquidity.

INTELLECTUAL PROPERTY

Plavix Litigation

Plavix is currently the Company's largest product ranked by net sales. Net sales of Plavix were approximately \$3.3 billion for the year ended December 31, 2006, \$3.8 billion for the year ended December 31, 2005 and \$3.3 billion in 2004, and U.S. net sales of Plavix were \$2.7 billion in 2006, \$3.2 billion in 2005 and \$2.8 billion in 2004. The Plavix patents are subject to a number of challenges in the U.S. and other less significant markets for the product. It is not possible reasonably to estimate the impact of these lawsuits on the Company. However, loss of market exclusivity of Plavix and sustained generic competition would be material to the Company's sales of Plavix and results of operations and cash flows, and could be material to the Company's financial condition and liquidity. The Company and Sanofi (the Companies) intend to vigorously pursue enforcement of their patent rights in Plavix.

Plavix Litigation –United States

Patent Infringement Litigation

The Company's U.S. territory partnership under its alliance with Sanofi is a plaintiff in a pending patent infringement lawsuit instituted in the U.S. District Court for the Southern District of New York entitled *Sanofi-Synthelabo, Sanofi-Synthelabo, Inc. and Bristol-Myers Squibb Sanofi Pharmaceuticals Holding Partnership v. Apotex Inc. and Apotex Corp. (Apotex)*. The suit was filed in March 2002, as is based on U.S. Patent No. 4,847,265 (the '265 Patent), a composition of matter patent, which discloses and claims, among other things, the hydrogen sulfate salt of clopidogrel, a medicine made available in the U.S. by the Companies as Plavix. Plaintiffs' infringement position is based on defendants' filing of their Abbreviated New Drug Applications (aNDA) with the FDA, seeking approval to sell generic clopidogrel bisulfate prior to the expiration of the composition of matter patent in 2011. The defendants responded by alleging that the patent is invalid and/or unenforceable.

In March 2006, the Companies announced that they had executed a proposed settlement agreement (the March Agreement) with Apotex to settle the patent infringement lawsuit pending between the parties in the U.S. District Court for the Southern District of New York. In response to concerns expressed by the Federal Trade Commission and state attorneys general, the parties modified the March Agreement (the Modified Agreement). In July 2006, the Companies announced that the Modified Agreement had failed to receive required antitrust clearance from the state attorneys general. On August 8, 2006, Apotex launched a generic version of clopidogrel bisulfate. On August 14, 2006, the Companies filed a motion for a preliminary injunction and on August 31, 2006, the trial court issued a preliminary injunction in which it ordered that Apotex to halt sales of generic clopidogrel bisulfate, but the Court did not order Apotex to recall product from its customers. The Companies were also required to post a bond in the amount of \$400 million to provide security to Apotex should the Court conclude at the end of the patent litigation that the injunction was wrongly imposed. On September 1, 2006, the Companies each posted a \$200 million bond to satisfy the requirement. The Company has pledged to the issuer of the bond collateral for its \$200 million bond consisting of short-term, high quality securities. This collateral is reported as marketable securities on the consolidated balance sheet at December 31, 2006. Under the terms of the pledge agreement, the Company is entitled to receive the income generated from the marketable securities and to make certain investment decisions, but is restricted from using the \$200 million pledged securities for any other purpose until such time the bond is cancelled.

On September 1, 2006, the Court denied Apotex's motion to stay the preliminary injunction. Apotex filed an appeal of the preliminary injunction to the U.S. Court of Appeals for the Federal Circuit on September 5, 2006 and filed a motion for stay of the injunction pending appeal on September 6, 2006, which the Federal Circuit denied on September 21, 2006. On December 8, 2006, the Federal Circuit affirmed the trial court's issuance of the injunction. Apotex subsequently filed a motion for reconsideration and/or rehearing, which was denied on January 19, 2007.

In September 2006, Apotex filed a motion to supplement its answer and counterclaims to add claims for breach of contract and antitrust counterclaims, and additional equitable defenses. The trial court permitted Apotex to add the additional antitrust counterclaims and they were stayed pending the outcome of the trial. The Court did not permit Apotex to add the breach of contract claim. The trial commenced on January 22, 2007 and ended on February 15, 2007. The Court has ordered post-trial briefing, and is expected to rule thereafter.

The Company's U.S. territory partnership under its alliance with Sanofi is also a plaintiff in three additional pending patent infringement lawsuits instituted in the U.S. District Court for the Southern District of New York against Dr. Reddy's Laboratories, Inc. and Dr. Reddy's Laboratories, LTD (Dr. Reddy's), Teva Pharmaceuticals USA, Inc. (Teva) and Cobalt Pharmaceuticals Inc. (Cobalt), all related to the '265 Patent. A trial date for the action against Dr. Reddy's has not been set. The patent infringement actions against Teva and Cobalt have been stayed pending resolution of the Apotex litigation, and the parties to those actions have agreed to be bound by the outcome of the litigation against Apotex, although Teva and Cobalt can appeal the outcome of the litigation. Each of Dr. Reddy's and Teva have filed an aNDA with the FDA, and all exclusivity periods and statutory stay periods under the Hatch-Waxman Act have expired, with the exception of the 30-month stay that applies to Teva, which expires on February 27, 2007. Accordingly, final approval by the FDA would provide each company authorization to distribute a generic clopidogrel bisulfate product in the U.S., subject to various legal remedies for which the companies may apply including injunctive relief and damages.

The Company's U.S. territory partnership under its alliance with Sanofi is a plaintiff in another pending patent infringement lawsuit instituted in the U.S. District Court for the District of New Jersey entitled *Sanofi-Synthelabo, Sanofi-Synthelabo Inc. and Bristol-Myers Squibb Sanofi Pharmaceuticals Holding Partnership v. Watson Pharmaceuticals, Inc. and Watson Laboratories, Inc.* The suit was filed in October 2004 and was based on U.S. Patent No. 6,429,210, which discloses and claims a particular crystalline or polymorph form of the hydrogen sulfate salt of clopidogrel, which is marketed as Plavix. The case is in the discovery phase. In December 2005, the court permitted Watson to pursue its declaratory judgment counterclaim with respect to U.S. Patent No. 6,504,030. In January 2006, the Court approved the parties' stipulation to stay this case pending the outcome of the trial in the Apotex matter.

It is not possible at this time reasonably to assess the patent litigation with Apotex, or the other Plavix patent litigation, or the timing of any renewed generic competition for Plavix from Apotex or additional generic competition for Plavix from other third-party generic pharmaceutical companies. However, if Apotex were to prevail in the patent litigation, the Company would expect to face renewed generic competition for Plavix from Apotex promptly thereafter. As noted above, loss of market exclusivity for Plavix and/or sustained generic competition would be material to the Company's sales of Plavix, results of operations and cash flows, and could be material to the Company's financial condition and liquidity.

The full impact of Apotex's launch of its generic clopidogrel bisulfate product on the Company cannot be reasonably estimated at this time and will depend on a number of factors, including, among others, the amount of generic product sold by Apotex; whether the Companies prevail in the underlying patent litigation; even if the Companies prevail in the pending patent case, the extent to which the launch by Apotex will permanently adversely impact the pricing and prescription demand for Plavix, the amount of damages that would be sought and/or recovered by the Companies, and Apotex's ability to pay such damages. Loss of market exclusivity of Plavix and/or sustained generic competition would be material to the Company's sales of Plavix, results of operations and cash flows, and could be material to the Company's financial condition and liquidity.

The launch of the generic clopidogrel bisulfate product by Apotex in August 2006 had a significant adverse effect on sales in 2006, which the Company estimates to be in the range of \$1.2 billion to \$1.4 billion. In particular, the launch had an adverse impact on sales in the third and fourth quarters of 2006, which the Company estimates to be in the range of \$525 million to \$600 million for the third quarter and \$700 to \$750 million for the fourth quarter. In the first, second, third, and fourth quarters of 2006, U.S. net sales for Plavix were \$850 million, \$988 million, \$474 million, and \$343 million, respectively. The sales of generic clopidogrel bisulfate are expected to have a residual impact on Plavix sales into 2007. The Company cannot with certainty estimate the 2007 impact at this point in time.

As also previously disclosed, the Antitrust Division of the U.S. Department of Justice (DOJ) is conducting a criminal investigation regarding the proposed settlement. The Company is cooperating fully with the investigation. It is not possible at this time reasonably to assess the outcome of the investigation or its impact on the Company.

As previously disclosed, the Company entered into a Deferred Prosecution Agreement (DPA) with the U.S. Attorney's Office for the District of New Jersey (USAO) on June 15, 2005. Pursuant to the DPA, the USAO filed a criminal complaint against the Company alleging conspiracy to commit securities fraud, but deferred prosecution of the Company and will dismiss the complaint after two years if the Company satisfies all the requirements of the DPA. Under the terms of the DPA, the USAO, in its discretion, may prosecute the Company for the matters that were the subject of the criminal complaint filed by the USAO against the Company in connection with the DPA should the USAO make a determination that the Company committed any criminal conduct. Under the DPA, "criminal conduct" is defined as any crime related to the Company's business activities committed by one or more executive officers or directors; securities fraud, accounting fraud, financial fraud or other business fraud materially affecting the books and records or publicly filed reports of the Company; and obstruction of justice. It is not possible at this time reasonably to assess the impact, if any, of the pending criminal investigation by the DOJ may have on the Company's compliance with the DPA. Additional information with respect to the DPA is included in "Item 7. Management's Discussion and Analysis—SEC Consent Order and Deferred Prosecution Agreement."

In September 2006, the Board of Directors (the Board) announced that the Company's then current Chief Executive Officer (CEO) and General Counsel would be leaving their respective positions effective immediately. The announcement took place after the Board received and considered reports from the Company's outside counsel on issues relating to the Plavix patent litigation with Apotex and a preliminary recommendation from the Monitor under the DPA (Monitor) to terminate the employment of such individuals. The Monitor's recommendation followed an investigation initiated by the USAO conducted by the Monitor and the USAO, into corporate governance issues relating to the Company's negotiations of a proposed settlement with Apotex. The Company had been advised by the Monitor and the USAO that the investigation did not involve matters that are the subject of the ongoing investigation by the Antitrust Division of the DOJ into the Plavix settlement agreement. At the time the Monitor made his preliminary recommendation, the Monitor and the USAO also advised the Company that they had not found a violation of the DPA or any unlawful conduct by the Company or its employees. The investigation included a review of whether there was any violation of Federal securities laws in connection with the proposed settlement with Apotex under the terms of the SEC Consent. The Monitor has completed his investigation and submitted his report on the investigation to the USAO. The Monitor's report did not find any violation of the SEC Consent or the Federal securities laws in connection with the proposed settlement. The Monitor concluded that the Company had violated certain paragraphs of the DPA related to governance matters. The violations cited by the Monitor in his report relate, among other things, to communication failures, including insufficient communications, by the Company's former CEO and former General Counsel with the Board and with other members of senior management, as well as failure to comply with certain internal Company policies and procedures. The Monitor did not make any findings with respect to whether the Company knowingly and materially breached the DPA or make any recommendations. The USAO has advised the Company that he believes the matters cited in the Monitor's report have been fully remediated and, accordingly, that he does not intend to take any action under the DPA with respect to the Monitor's report.

Antitrust Litigation

Eighteen lawsuits comprised of both individual suits and purported class actions have been filed against the Company in U.S. District Court, Southern District of Ohio, Western Division, by various plaintiffs, including pharmacy chains (individually and as assignees, in whole or in part, of certain wholesalers), various health and welfare benefit plans/funds and individual residents of various states, since the announcement of the March Agreement with Apotex in March 2006. These lawsuits allege, among other things, that the Apotex settlement violates the Sherman Act and related laws. Plaintiffs are seeking, among other things, permanent injunctive relief barring the Apotex settlement and/or monetary damages. The class actions filed on behalf of direct purchasers have been consolidated under the caption *In re: Plavix Direct Purchaser Antitrust Litigation*, and the class actions filed on behalf of indirect purchasers have been consolidated under the caption *In re: Plavix Indirect Purchaser Antitrust Litigation*. Amended complaints have been filed in each of the consolidated class actions and in the individual actions, since the July 2006 announcement that the Modified Agreement failed to receive required antitrust clearance from the state attorneys general. The amended complaints include allegations regarding the criminal investigation by the Antitrust Division of the DOJ. On November 2, 2006, the Companies filed a motion to transfer all eighteen lawsuits to the U.S. District Court for the Southern District of New York, where the Apotex matter and similar Plavix-related patent infringement cases are pending. That motion is pending before the Court. The Court also will be considering whether to stay the litigation pending the outcome of the patent infringement litigation. It is not possible at this time reasonably to assess the outcome of these lawsuits or their impact on the Company.

Shareholder Derivative Lawsuits

In September 2006, certain members of the Board, current and former officers, and the Company were named in a derivative complaint, *Steven W. Sampson v. Peter R. Dolan, et al.*, filed in New York State Supreme Court. Also in September 2006, certain members of the Board, current and former officers, and the Company were named in a derivative complaint, *Americo Marchese v. Peter R. Dolan et al.*, filed in the U.S. District Court for the Southern District of New York. The complaints allege, among other things, breaches of fiduciary duty and claims for contribution and indemnification in relation to negotiations with Apotex regarding the Plavix patent litigation. Among other things, the complaints seek money damages, injunctive remedies and other forms of equitable relief. It is not possible at this time reasonably to assess the outcome of these lawsuits or their impact on the Company. Plaintiff Marchese voluntarily dismissed without prejudice because the named plaintiff had sold his Bristol-Myers Squibb stock.

Consumer Fraud

On November 3, 2006, the Companies were served with a purported class action complaint, subsequently amended to include various Sanofi entities, captioned. *Skilstaf, Inc. v. Bristol-Myers Squibb Company, et al.*, (3:06 CV 04965) filed in the U.S. District Court, District of New Jersey. The complaint alleges that defendants misrepresented the safety and effectiveness of Plavix, both alone and in combination with aspirin, and that third-party payors were misled, causing them to pay more for Plavix prescriptions for their insureds, compared to lower cost alternatives. Plaintiffs assert, among other things, violations of the New Jersey Consumer Fraud Act. Plaintiffs seek compensatory and punitive damages. It is not possible at this time reasonably to assess the outcome of this lawsuit or the impact on the Company.

Plavix Litigation – International

Sanofi-Synthelabo and Sanofi-Synthelabo Canada Inc. instituted a prohibition action in the Federal Court of Canada against Apotex Inc. and the Minister of Health in response to a Notice of Allegation (NOA) from Apotex Inc. directed against Canadian Patent No. 1,336,777 (the ‘777 Patent) covering clopidogrel bisulfate. Apotex’s NOA indicated that it had filed an Abbreviated New Drug Submission (ANDS) for clopidogrel bisulfate tablets and that it sought approval (a Notice of Compliance) of that ANDS before the expiration of the ‘777 Patent, which is scheduled for August 12, 2012. Apotex’s NOA further alleged that the ‘777 Patent was invalid or not infringed. In March 2005, the Canadian Federal Court of Ottawa rejected Apotex’s challenge to the Canadian Plavix patent and held that the asserted claims are novel, not obvious and infringed, and granted Sanofi’s application for an order of prohibition against the Minister of Health and Apotex Inc. That order of prohibition precludes approval of Apotex’s ANDS until the patent expires in 2012, unless the Federal Court’s decision is reversed on appeal. Apotex filed an appeal, which the Canadian Federal Court of Appeal heard on December 12-13, 2006. On December 22, 2006, the Federal Court of Appeal dismissed Apotex’s appeal and upheld the Federal Court’s issuance of the order of prohibition. On February 20, 2007, Apotex filed leave to appeal this decision to the Supreme Court of Canada.

Sanofi and Sanofi-Synthelabo Canada instituted a prohibition action in the Federal Court of Canada against Cobalt and the Minister of Health in response to a NOA from Cobalt directed against the ‘777 Patent and Canadian Patent No. 2,334,870 (the ‘870 Patent). Cobalt’s NOA indicated that it has filed an ANDS for clopidogrel bisulfate tablets and that it sought a Notice of Compliance for that ANDS before the expiration of the ‘777 and ‘870 Patents. Cobalt alleged that the ‘777 Patent was invalid and that the ‘870 Patent was invalid and not infringed. The case has been stayed pending the outcome of the Apotex appeal.

In June 2006, the Korean Intellectual Property Tribunal invalidated all claims of Sanofi’s Korean Patent No. 103,094, including claims directed to clopidogrel and pharmaceutically acceptable salts and to clopidogrel bisulfate, and Sanofi has appealed. Sanofi has also commenced infringement actions against generic pharmaceutical companies, several of which have launched a generic clopidogrel bisulfate product in Korea. It is not possible at this time reasonably to assess the outcome of these lawsuits or the impact on the Company.

OTHER INTELLECTUAL PROPERTY LITIGATION

Tequin (injectable form)

The Company and Kyorin Pharmaceuticals Co., Ltd. (Kyorin) commenced patent infringement actions in March 2005, against Apotex, and against Sicom Pharmaceuticals, Inc., Sicom Inc., Sicom Pharmaceuticals Sales Inc., Teva and Teva Pharmaceutical Industries Ltd. in the U.S. District Court for the Southern District of New York, relating to injectable forms of the antibiotic gatifloxacin, for which Kyorin holds the composition of matter patent and which the Company sells as *Tequin*. The action related to Apotex’s and Sicom’s filing of aNDAs for generic versions of injectable gatifloxacin with P(IV) certifications that the composition of the matter patent, which expires December 2007 but which was granted a patent term extension until December 2009, is invalid. The filing of the lawsuits placed stays on the approvals of both Apotex’s and Sicom’s generic products until July/August 2007, unless there is a court decision adverse to the Company and Kyorin before that date. The Sicom case was consolidated with the above proceeding. In a stipulation approved by the U.S. District Court for the Southern District of New York in August 2005, the parties agreed that the Apotex case will be stayed pending resolution of the Teva and Sicom cases, and that the parties will be bound by the outcome of the litigation. In August 2006, the court approved a stipulation of dismissal jointly submitted by the parties. Under the stipulation, plaintiffs’ claims against Teva and Sicom were dismissed without prejudice. Both Teva and Sicom’s counterclaims concerning claim 4 of U.S. Patent No. 4,980,470 were dismissed with prejudice. Both Teva and Sicom’s remaining counterclaims were dismissed without prejudice. The Apotex case remains pending. It is not possible at this time reasonably to assess the outcome of the Apotex lawsuit. However, as a result of the Company’s decision to discontinue the manufacture, distribution and sale of *Tequin*, it is not expected that the outcome of the Apotex lawsuit will have a material impact on the Company.

[Erbix](#)
[Yeda Litigation](#)

In October 2003, Yeda Research and Development Company Ltd. (Yeda) filed suit against ImClone and Aventis Pharmaceuticals, Inc. in Federal court claiming that three individuals associated with Yeda should be named as inventors of U.S. Patent No. 6,217,866 (the '866 Patent), which covers the therapeutic combination of any EGFR – specific monoclonal antibody and anti-neoplastic agents, such as chemotherapeutic agents, for use in treatment of cancer. In September 2006, following trial the Court issued an opinion and order in which it held that three researchers at Yeda were the sole inventors of the subject matter of the '866 Patent, and giving complete ownership of the patent to Yeda. ImClone has appealed. ImClone also filed a declaratory judgment action in the U.S. District Court for the Southern District of New York. The complaint alleges that if the Yeda researchers remain sole inventors of the '866 Patent, the patent is invalid. The Company, which is not a party to this action, is unable to predict the outcome of these proceedings.

As a result of the Court's decision, Yeda may seek damages for infringement with respect to past Erbitux sales and royalties on future Erbitux sales. Yeda also has the right to license the patent to others. Yeda's license of the patent to third parties could result in product competition for Erbitux that might not otherwise occur. It is too early to assess whether and to what extent any such competitive impact will occur or to quantify any such impact. However, Yeda has announced that it has licensed the patent to Amgen Inc. (Amgen). Amgen received FDA approval to market an EGFR product that competes with Erbitux. Under its commercial agreement with ImClone, the Company pays a royalty to ImClone on sales of Erbitux that is not impacted by the Court's decision.

The agreement between ImClone and the Company also includes provisions pursuant to which certain financial consequences to the Company resulting from the decision would be the responsibility of ImClone. In addition, the Company owns 14.4 million shares of ImClone common stock, which the Company accounts for under the equity method of accounting and has a carrying value of \$7.59 per share at December 31, 2006. The closing market price of ImClone common stock at December 31, 2006 was \$26.76. There can be no assurance that the Company will be able to realize fully the benefits of the contractual protections in its commercial agreement with ImClone or that there will not be any other financial consequences to the Company as a result of the Court's decision.

[RepliGen Litigation](#)

In 2004, RepliGen Corporation (Repligen) and Massachusetts Institute of Technology (MIT) filed a lawsuit in the U.S. District Court for the District of Massachusetts against ImClone, claiming that ImClone's manufacture and sale of Erbitux infringes a patent that generally covers a process for protein production in mammalian cells. In July 2006, the Court granted summary judgment in favor of Repligen and MIT by rejecting one of ImClone's defenses relating to patent exhaustion. The trial will proceed on the issue of patent infringement. The Company is not a party to this action. It is not possible at this time reasonably to assess the outcome of this lawsuit or the impact on the Company.

[Abbott Laboratories Litigation](#)

On February 5, 2007, Abbott Laboratories filed suit against ImClone in the U.S. District Court for the District of Massachusetts (Case 1:07-cv-10216-RGS). The complaint alleges that ImClone's manufacture and sale of Erbitux infringe U.S. Patent No. 5,665,578, and seeks damages for that alleged infringement. The Company is not a party to this action. It is not possible at this time reasonably to assess the outcome of this lawsuit or the impact on the Company.

[Orencia](#)

In January 2006, Repligen and the Regents of the University of Michigan filed a complaint against the Company in the U.S. District Court for the Eastern District of Texas, Marshall Division. *Orencia* was launched in February 2006. The complaint alleges that the Company's then-anticipated sales of *Orencia* will infringe U.S. Patent No. 6,685,541. Repligen has since amended the complaint to include ongoing and future sales of *Orencia*. In August 2006, Zymogenetics, Inc. filed a complaint against the Company in the U.S. District Court for the District of Delaware. The complaint alleges that the Company's manufacture and sales of *Orencia* infringe U.S. Patents Nos. 5,843,725 and 6,018,026. The trial is scheduled to commence in April 2008. It is not possible at this time reasonably to assess the outcome of these lawsuits or their impact on the Company.

GENERAL COMMERCIAL LITIGATION

Clayworth Litigation

The Company, together with a number of other pharmaceutical manufacturers, was named as a defendant in an action filed in California State Superior Court in Oakland, *James Clayworth et al. v. Bristol-Myers Squibb Company, et al.*, alleging that the defendants conspired to fix the prices of pharmaceuticals by agreeing to charge more for their drugs in the U.S. than they charge outside the U.S., particularly Canada, and asserting claims under California's Cartwright Act and unfair competition law. The plaintiffs sought trebled monetary damages, injunctive relief, and other relief. On December 19, 2006, the Court granted the Company and the other manufacturers' motion for summary judgment based on the pass-on defense, and judgment was then entered in favor of defendants. In January 2007, a notice of appeal with respect to the judgment was filed and remains pending. It is not possible at this time reasonably to assess the outcome of this lawsuit or its impact on the Company in the event plaintiffs are successful on appeal.

Weisz & Stephenson Litigations

The Company has been named as a defendant, along with many other pharmaceutical companies, in an action originally brought by the Utility Consumers Action Network, a consumer advocacy organization that focuses on privacy issues. The lawsuit entitled *Utility Consumers Action Network on behalf of the Privacy Rights Clearinghouse, et al. v. Bristol-Myers Squibb Co., et al* was filed in California State Superior Court, San Diego County in July 2004. Another substantially similar lawsuit, *Rowan Klein, a Representative Action on Behalf of Similarly Situated Persons and the Consuming Public, v. Walgreens, et al.*, was filed in February 2005, in the same court, against retail pharmacies, the Company and other pharmaceutical companies. The two complaints seek equitable relief, monetary damages and attorneys' fees based upon allegedly unfair business practices and untrue and misleading advertising under various California statutes, including the California Confidentiality of Medical Information Act based on allegations that retail stores are selling consumers' confidential medical information and that the companies are using consumers' medical information for direct marketing designed to increase the sale of targeted drugs.

In January 2005, the Company and other pharmaceutical defendants sought to dismiss the Utility Consumers Action Network case on the grounds that California's Proposition 64 requires that a plaintiff must be the injured party in order to have standing to bring a suit and that Utility Consumers Action Network was not personally injured. In October 2005, the Court entered a stay in the Utility Consumers Action Network and the Klein cases pending the California Supreme Court's decision to review several intermediate appellate decisions that discuss the applicability of Proposition 64 to pending cases. In July 2006, the California Supreme Court entered decisions in two appeals which held that Proposition 64 applies to pending cases, but complaints may be amended to add a plaintiff with standing. The Court granted plaintiffs in both lawsuits leave to amend, and amended complaints containing substantially similar allegations to the earlier complaints were filed on behalf of new plaintiffs who each purports to allege a personal injury. The lawsuit filed by Utility Consumers Action Network on behalf of the Privacy Rights Clearinghouse is now entitled, *Kimberly Weisz, et al. v. Bristol-Myers Squibb Co., et al.*, and the lawsuit filed by Rowan Klein is now entitled, *Roseanna Stephenson, on behalf of herself and all others similarly situated, v. Bristol-Myers Squibb Co., et al.* Both cases are at a very preliminary stage, and it is not possible at this time reasonably to assess the outcome of these lawsuits or their impact on the Company.

RxUSA Wholesale Litigation

In July 2006, a complaint was filed by drug wholesaler RxUSA Wholesale, Inc. in the U.S. District Court for the Eastern District of New York against the Company, fifteen other drug manufacturers, five drug wholesalers, two officers of defendant McKesson and a wholesale distribution industry trade group, *RxUSA Wholesale, Inc. v. Alcon Labs., Inc., et al.* The complaint alleges violations of Federal and New York antitrust laws, as well as various other laws. Plaintiff claims that defendants allegedly engaged in anti-competitive acts that resulted in the exclusion of plaintiff from the relevant market and seeks \$586 million in damages before any trebling, and other relief. The Company, together with the other manufacturer defendants, filed a motion to dismiss the case on November 13, 2006. That motion is pending before the Court. It is not possible at this time reasonably to estimate the outcome of this lawsuit or the impact on the Company.

SECURITIES LITIGATION & INVESTIGATIONS

SEC Investigation of Wholesaler Inventory & Accounting Matters

In August 2004, the Company entered into a final settlement with the SEC, concluding an investigation concerning certain wholesaler inventory and accounting matters. The Company agreed, without admitting or denying any liability, not to violate certain provisions of the securities laws. The Company also established a \$150 million fund, which is being distributed to certain Company shareholders under a plan of distribution established by the SEC. The settlement does not resolve the ongoing investigation by the SEC of the activities of certain former members of the Company's management in connection with the wholesaler inventory issues and other accounting matters. The Company is continuing to cooperate with this investigation.

D&K Health Care Resources Litigation

In November 2004, a class action complaint was filed in the U.S. District Court for the Eastern District of Missouri against the Company, D&K Health Care Resources, Inc. (D&K) and several current and former D&K directors and officers. The complaint alleges that the Company participated in fraudulently inflating the value of D&K stock by allegedly engaging in improper “channel-stuffing” agreement with D&K. In June 2006, the Court granted the Company’s motion to dismiss the complaint. Plaintiff’s time to appeal the decision, if any such appeal is lodged, will begin to run when the litigation against D&K and its officers and directors is finally resolved. It is not possible at this time reasonably to assess the outcome of this lawsuit or its impact on the Company.

Starkman Litigation

In September 2005, certain of the Company’s current and former officers were named in a purported class action, *Starkman v. Bristol-Myers Squibb, et al.*, filed in New York State Supreme Court alleging factual claims similar to the now resolved Federal class action in the U.S. Southern District of New York related to alleged violations of Federal securities laws and regulations in connection with sales incentives and wholesaler inventory levels, and asserting common law fraud and breach of fiduciary duty claims on behalf of certain of the Company’s stockholders. In October 2005, the Company removed the case to the U.S. District Court for the Southern District of New York. In November 2005, the plaintiff moved to remand the matter to state court. The matter was stayed until the Supreme Court, in March 2006, entered its decision in another case, which held that holder class actions asserting securities fraud claims under state law, like *Starkman*, are preempted under Federal law. Following oral argument, the Court denied plaintiff’s motion to remand in September 2006. On November 8, 2006, the Company and the plaintiff submitted a stipulation of dismissal (without prejudice), which was approved by the Court.

PRICING, SALES AND PROMOTIONAL PRACTICES LITIGATION AND INVESTIGATIONS

The Company, together with a number of defendants, is a defendant in a number of private civil matters relating to its pricing practices. In addition, the Company, together with a number of other pharmaceutical manufacturers, has received subpoenas and other document requests from various government agencies seeking records relating to its pricing, sales marketing practices and best price reporting.

Investigations

The Company, the U.S. DOJ, and the Office of the U.S. Attorney for the District of Massachusetts have reached an agreement in principle, subject to approval by the DOJ, to settle several investigations involving the Company’s drug pricing, and sales and marketing activities. The agreement in principle provides for a civil resolution and an expected payment of \$499 million. The agreement in principle involves matters that have been actively investigated by and discussed with U.S. DOJ and the U.S. Attorney for the District of Massachusetts over a number of years, including matters relating to (1) the pricing for certain products sold several years ago by a subsidiary, which had been reimbursed by governmental health care programs; 2) financial relationships between the subsidiary noted above and certain customers and other entities; 3) certain consulting programs; 4) the promotion of Abilify for unapproved indications; 5) the calculation of certain Medicaid rebates for *Serzone* (nefazodone hydrochloride); and 6) the pricing for certain of the Company’s products reimbursed by governmental health care programs. The agreement contemplates that States will choose to participate in the settlement. There would be no criminal charges against the Company with respect to those matters. The agreement in principle also provides for the Company to enter into a corporate integrity agreement with the Office of Inspector General of the U.S. Department of Health and Human Services. The settlement is contingent upon the parties’ agreement to the terms of a final settlement agreement, including on the terms of the corporate integrity agreement and approval by the DOJ. There can be no assurance that the settlement will be finalized, or that all the States will choose to participate. The agreement in principle only covers those matters outlined above, and the U.S. DOJ, the U.S. Attorney for the District of Massachusetts and the States have indicated that they may pursue other matters outside the scope of the expected settlement, and in that event such matters could result in the assertion of civil and/or criminal claims.

As a result of the agreement in principle, the Company has increased its reserves related to these investigations by \$353 million, bringing the aggregate reserves for these matters to \$499 million. The increased reserve was recorded in the fourth quarter of 2006. In accordance with GAAP, the aggregate reserves reflect the Company’s estimate of the expected probable loss with respect to these matters, assuming the settlement is finalized. If the settlement is not finalized, and/or if certain States choose not to participate, the amount reserved may not reflect eventual losses.

Furthermore, there are other open investigations on other issues being conducted by various Federal and state agencies as well as by certain Congressional committees. The Company is producing documents and actively cooperating with these investigations, which could result in the assertion of civil and/or criminal claims.

It is not possible at this time reasonably to assess the outcome of the investigations described above, or of any additional matters that the U.S. DOJ, and the Office of the U.S. Attorney for the District of Massachusetts may pursue, or the potential impact on the Company.

As previously disclosed, in 2004, the Company undertook an analysis of its methods and processes for calculating prices for reporting under governmental rebate and pricing programs related to its U.S. Pharmaceuticals business. The analysis was completed in early 2005. Based on the analysis, the Company identified the need for revisions to the methodology and processes used for calculating reported pricing and related rebate amounts and implemented these revised methodologies and processes beginning with its reporting to the Federal government agency with primary responsibility for these rebate and price reporting obligations, the Centers for Medicare and Medicaid Services (CMS) in the first quarter of 2005. In addition, using the revised methodologies and processes, the Company also has recalculated the “Best Price” and “Average Manufacturer’s Price” required to be reported under the Company’s Federal Medicaid rebate agreement and certain state agreements, and the corresponding revised rebate liability amounts under those programs for the three-year period 2002 to 2004. Upon completion of the analysis in early 2005, the Company determined that the estimated rebate liability for those programs for the three-year period 2002 to 2004 was actually less than the rebates that had been paid by the Company for such period. Accordingly, in the fourth quarter of 2004, the Company recorded a reduction to the rebate liability in the amount of the estimated overpayment. The Company has submitted proposed revisions and an updated estimate to CMS for review. CMS may take the position that further revisions to the Company’s methodologies and calculations are required. The Company believes, however, based on current information that any such recalculation for 2002 to 2004 period is not likely to result in material rebate liability. However, due to the uncertainty surrounding the recoverability of the Company’s estimated overpayment arising from the review process described above, the Company recorded a reserve in an amount equal to the estimated overpayment.

Litigation

With respect to the private civil matters, the Company, together with a number of other pharmaceutical manufacturers, is a defendant in private class actions, as well as suits brought by the attorneys general of several states and by numerous New York counties and the City of New York, which are pending in Federal and state courts. In these actions, plaintiffs allege defendants caused the Average Wholesale Prices (AWPs) of their products to be inflated, thereby injuring government programs, entities and persons who reimbursed prescription drugs based on AWPs. The Federal cases and several of the state attorneys general actions and suits of New York Counties and the City of New York have been consolidated for pre-trial purposes in the U.S. District Court for the District of Massachusetts (AWP MDL). The Court in the AWP MDL has certified three classes of persons and entities who paid for or reimbursed for seven of the Company’s physician-administered drugs. The non-jury trial for Classes 2 and 3 (insurance companies and health and welfare funds in Massachusetts) commenced November 2006 and is currently ongoing. A trial date for the claims of Class 1 (Medicare Part B beneficiaries nationwide) has not yet been set for the Company.

The Company also is one of many defendants in a putative class action filed in California allegedly on behalf of entities entitled to discounted pricing pursuant to Section 340B of the Public Health Services Act, which requires prescription drug manufacturers to offer discounts to qualified medical providers – generally those who disproportionately service poor people. In July 2006, an order was entered dismissing the California case with prejudice. Plaintiff has appealed the dismissal of the California action.

It is not possible at this time reasonably to assess the outcome of the litigation matters described above, or their potential impact on the Company.

PRODUCT LIABILITY LITIGATION

The Company is a party to various product liability lawsuits. These involve, among other things, hormone replacement therapy (HRT) products and the Company’s *Serzone* prescription drug. In addition to lawsuits, the Company also faces unfiled claims involving these and other products.

The Company’s decision to obtain insurance coverage is dependent on market conditions, including cost and availability, existing at the time such decisions are made. As a result of external factors, the availability of insurance continues to be restrictive while the cost has increased significantly. The Company has evaluated its risks and has determined that the cost of obtaining insurance for product liability losses outweighs the benefits of coverage protection against such losses and as such, became self-insured for product liability losses effective July 1, 2004. The Company will continue to evaluate these risks and benefits to determine its insurance needs in the future.

Serzone

Serzone is an antidepressant that was launched by the Company in May 1994, in Canada and in March 1995, in the U.S. In December 2001, the Company added a black box warning to its *Serzone* label warning of the potential risk of severe hepatic events including possible liver failure and the need for transplantation and risk of death. Within several months of the black box warning being added to the package insert for *Serzone*, a number of lawsuits, including several class actions, were filed against the Company. The plaintiffs in this mass-tort litigation allege, among other things, that the Company knew or should have known about the hepatic risks posed by *Serzone* and failed to adequately warn physicians and users of the risks. In addition to the cases filed in the U.S., class actions were filed in Canada. Without admitting any wrongdoing or liability, in October 2004, the Company entered into a settlement agreement with respect to all claims in the U.S. and its territories regarding *Serzone*. In November 2004, the District Court conditionally certified the temporary settlement class and preliminarily approved the settlement. In September 2005, the Court issued an opinion granting final approval of the settlement. In August 2006, the Company agreed to proceed with the settlement and not exercise its back-end opt-out right. Without admitting any wrongdoing or liability, in September 2006, the Company reached an agreement in principle with respect to all claims in Canada regarding *Serzone*. Pursuant to the terms of the proposed settlement, all claims will be dismissed, the litigation will be terminated, the defendants will receive releases and the Company committed to paying at least \$1 million into funds for class members. In May 2004, the Company announced that, following an evaluation of the commercial potential of the product after generic entry into the marketplace and rapidly declining brand sales, it had decided to discontinue the manufacture and sale of the product in the U.S. effective June 14, 2004.

Hormone Replacement Therapy

The plaintiffs in this mass-tort litigation allege, among other things, that various hormone therapy products, including hormone therapy products formerly manufactured by the Company (Estrace, Estradiol, Delestrogen and Ovcon) cause breast cancer, stroke, blood clots, cardiac and other injuries in women, that the defendants were aware of these risks and failed to warn consumers. As of December 31, 2006, the Company was a defendant in 333 lawsuits filed on behalf of approximately 1,261 plaintiffs in Federal and state courts throughout the U.S. The Company expects to be dismissed from many cases in which its products were never used. The initial trials in the HRT litigation involving the primary defendant, Wyeth commenced in Federal court in July 2006 and in Pennsylvania in November 2006. The initial trials involve only breast cancer claims and the Company is not a defendant in any of these cases. All of the Company's hormone therapy products were sold to other companies between January 2000 and August 2001, but the Company maintains the Estrace aNDA, and continues to manufacture some of the products under a supply agreement. It is not possible at this time reasonably to assess the outcome of the lawsuits in which the Company is a party or their impact on the Company.

ENVIRONMENTAL PROCEEDINGS

As previously reported, the Company is a party to several environmental proceedings and other matters, and is responsible under various state, Federal and foreign laws, including the Comprehensive Environmental Response, Compensation and Liability Act, (CERCLA), for certain costs of investigating and/or remediating contamination resulting from past industrial activity at the Company's current or former sites or at waste disposal or reprocessing facilities operated by third parties.

CERCLA Matters

With respect to CERCLA matters for which the Company is responsible under various state, Federal and foreign laws, the Company typically estimates potential costs based on information obtained from the U.S. Environmental Protection Agency (EPA), or counterpart state agency and/or studies prepared by independent consultants, including the total estimated costs for the site and the expected cost-sharing, if any, with other "potentially responsible parties", and the Company accrues liabilities when they are probable and reasonably estimable. As of December 31, 2006, the Company estimated its share of the total future costs for these sites to be approximately \$67 million, recorded as other liabilities, which represents the sum of best estimates or, where no simple estimate can reasonably be made, estimates of the minimal probable amount among a range of such costs (without taking into account any potential recoveries from other parties, which are not currently expected). The Company has paid less than \$6 million (excluding legal fees) in each of the last five years for investigation and remediation of such matters, including liabilities under CERCLA and for other on-site remedial obligations.

Puerto Rico Air Emissions Civil Litigation

As previously reported, the Company is one of several defendants, including many of the major U.S. pharmaceutical companies, in a purported class action suit filed in Superior Court in Puerto Rico in February 2000 relating to air emissions from a government owned and operated wastewater treatment facility. In April 2006, the Company executed an individual settlement with the plaintiffs in the amount of \$460,000, subject to certain conditions, including that the Court would decide to certify the case as a class action. The Court deferred decision on class certification pending its review of expert reports on the facility's operations. The Court considered the expert reports at a hearing in October 2006 and thereafter facilitated settlement discussions as to all parties and all claims. Those discussions are ongoing and, consequently, the class certification hearing, scheduled for December 2006, has been postponed until May 2007.

[Passaic River \(NJ\) Remediation and Natural Resource Damages Claims](#)

In September 2003, the New Jersey Department of Environmental Protection (NJDEP) issued an administrative enforcement Directive and Notice under the New Jersey Spill Compensation and Control Act requiring the Company and approximately 65 other companies to perform an assessment of natural resource damages and to implement unspecified interim remedial measures to restore conditions in the Lower Passaic River. The Directive alleges that the Company is liable because it historically sent bulk waste to the former Inland Chemical Company facility in Newark, NJ (now owned by McKesson Corp.) for reprocessing, and that releases of hazardous substances from this facility have migrated into Newark Bay and continue to have an adverse impact on the Lower Passaic River watershed. Subsequently, the EPA also issued a notice letter under CERCLA to numerous parties—but not including the Company—seeking their cooperation in a study of conditions in substantially the same portion of the Passaic River that is the subject of the NJDEP’s Directive. A group of these other parties entered into a consent agreement with EPA in 2004 to finance a portion of that study. The EPA has not yet determined the estimated cost of the study. Under the consent agreement, the private party group committed to pay roughly half of the \$20 million estimate, subject to revision and future negotiation. This study may also lead to clean-up actions, directed by the EPA and the Army Corps of Engineers. That group is actively negotiating with the EPA; if successful, those negotiations will result in an amended consent agreement. In anticipation of that agreement, the Company has reached an agreement in principle with McKesson Corp. to share the costs of an anticipated agreed portion of the EPA study tasks. The Company also is working cooperatively with a group of the parties that received the NJDEP Directive and/or the EPA notice to explore potential resolutions of the Directive and to address the risk of collateral claims. Although the Company does not believe it has caused or contributed to any contamination in the Lower Passaic River watershed, the Company has informed the NJDEP that it is willing to discuss the NJDEP’s allegations against the Company. Also, the private party group continues to discuss with the Federal agencies designated as trustees of natural resources affected by contamination in the Passaic River watershed the possibility of funding a cooperative NRD study that presumably would dovetail with the ongoing EPA study, and ideally would be joined by the NJDEP, to coordinate actions NJDEP may seek under the Directive. In late 2005, the NJDEP issued a supplemental Directive and filed suit against one of the site parties, seeking to compel implementation of interim measures. It is unclear whether the NJDEP will take additional actions against other site parties and/or whether litigation will arise in response to these new claims. The extent of any liability the Company may face, either to NJDEP or EPA, or with respect to future claims by the Federal trustees, McKesson Corp. or other responsible parties, cannot yet be determined.

[North Brunswick, NJ Board of Education Remediation Claims](#)

In October 2003, the Company was contacted by the North Brunswick, NJ Board of Education (BOE) regarding the discovery of industrial waste materials allegedly including materials from E.R. Squibb and Sons during an expansion project at the North Brunswick Township High School, as well as at a number of neighboring residential properties and adjacent public park areas. In January 2004, the NJDEP sent the Company and others an information request letter about possible waste disposal at the site, to which the Company responded in March 2004. The BOE and the Township, who are the current owners of the school property and the park, are conducting and jointly financing soil remediation work under a work plan approved by the NJDEP, and are evaluating the need to conduct response actions to remediate or contain potentially impacted ground water. Due to financial constraints in late 2004, the BOE asked the Company to contribute funds on an interim basis to assure uninterrupted performance of necessary site work. The Company is actively monitoring the clean-up project, including its costs, and is discussing with the BOE and Township the terms of a cooperative funding agreement and allocation process. Municipal records indicate the Township operated a landfill at the site in the 1940’s through the 1960’s, and the Company is investigating the historic use of the site, including any activities for which the Company may be responsible. To date, neither the BOE nor the Township has asserted any claims against the Company.

[NJDEP Air Permit – New Brunswick, NJ Facility](#)

In December 2003, the Company and the NJDEP entered an Administrative Consent Order (ACO) concerning alleged violations of the New Jersey Air Pollution Control Act and its implementing regulations at the Company’s New Brunswick facility. Pursuant to the ACO, the Company agreed to submit a permit application creating a facility-wide emissions cap and to pay a small administrative fine. Both of these obligations were satisfied in early 2004. Subsequently, in February, 2005, the ACO was amended to provide that the Company would install a new cogeneration turbine at its New Brunswick facility by December 31, 2006, and would obtain applicable air permits by December 31, 2005. The Company obtained the required Operating Permit in September 2006, purchased the new cogeneration turbine at a cost of approximately \$5 million and installed the turbine by December 31, 2006, in compliance with the ACO. The Company has fulfilled all terms and conditions of the ACO and in February 2007 received notice of termination from the ACO by the NJDEP, which concludes this matter.

Mead Johnson Facility – NSPS Issue

In October 2005, the Company commenced a voluntary environmental audit of the Mead Johnson facility in Mt. Vernon, Indiana, to determine its compliance with the EPA's new source performance standards (NSPS), which are applicable to the operation of an incinerator. In December 2005, the Company disclosed possible violations of the NSPS requirement and is currently in the process of modifying its operations to fall within an exemption from those requirements. To date, neither the EPA nor the Indiana Department of Environmental Management has pursued any penalties for these potential violations; however, the Company could potentially be subject to civil penalties for past non-compliance with the NSPS. In December 2006, EPA responded to the self-disclosure and stated that it does not intend to pursue an enforcement action for these issues at this time. It is possible, however, that the Indiana Department of Environmental Management could in the future pursue civil penalties for past non-compliance with the NSPS.

ODS Regulatory Compliance

The EPA is investigating industrial and commercial facilities throughout the U.S. that use refrigeration equipment containing ozone-depleting substances (ODS) and enforcing compliance with regulations governing the prevention, service and repair of leaks (ODS requirements). In 2004, the Company performed a voluntary corporate-wide audit at its facilities in the U.S. and Puerto Rico that use ODS-containing refrigeration equipment. The Company submitted an audit report to the EPA in November 2004, identifying potential violations of the ODS requirements at several of its facilities. In addition to the matters covered in the Company's audit report letter to the EPA, the EPA previously sent the Company's wholly owned subsidiary, Mead Johnson, a request for information regarding compliance with ODS requirements at its facility in Evansville, Indiana. The Company responded to the request in June 2004, and, as a result, identified potential violations at the Evansville facility. The Company currently is in discussions with EPA to resolve both the potential violations discovered during the audit and those identified as a result of the EPA request for information to the Evansville facility. If the EPA determines that the Evansville facility, or any other facilities, was, or is, in violation of applicable ODS requirements, the Company could be subject to penalties and/or be required to convert or replace refrigeration equipment to use non-ODS approved substitutes.

MACT Compliance – Puerto Rico Facilities (Barceloneta and Humacao)

In March 2005, the Company commenced a voluntary environmental audit of the Barceloneta and Humacao, Puerto Rico facilities to determine their compliance with EPA's regulations regarding the maximum achievable control technology requirements for emissions of hazardous air pollutants from pharmaceuticals production (Pharmaceutical MACT). The Company submitted to EPA an audit report for the Humacao facility in June 2005 and for the Barceloneta facility in July 2005, which disclosed potential violations of the Pharmaceutical MACT requirements at both facilities. The Company and the EPA are currently in discussions regarding resolution of this matter.

OTHER PROCEEDINGS

SEC Germany Investigation

In October 2004, the SEC notified the Company that it is conducting an informal inquiry into the activities of certain of the Company's German pharmaceutical subsidiaries and its employees and/or agents. On October 4, 2006, the SEC informed the Company that its inquiry is now formal. The SEC's inquiry encompasses matters currently under investigation by the German prosecutor in Munich, Germany. The Company understands the inquiry and investigation concern potential violations of the Foreign Corrupt Practices Act and German law, respectively. The Company is cooperating with both the SEC and the German authorities. The Company has established an accrual, which represents minimum expected probable losses with respect to the investigation by the German prosecutor. It is not possible at this time reasonably to assess the outcome of these investigations or their impact on the Company.

Bari, Italy Investigation

As previously disclosed, in January 2006, the Company was notified by the Prosecutor in the Bari region of Italy (Bari Prosecutor) that the Company is under investigation as a result of the activities of two of its employees in the region. The investigation involves the Company, as well as a number of doctors, pharmacists, pharmaceutical companies and their sales representatives. The main allegation is that the parties were engaged in a plan to defraud the National Health Service. The Bari Prosecutor also alleges that the companies lacked appropriate compliance controls and/or processes and procedures to control the activities of their sales representatives. The Bari Prosecutor had requested to suspend the operations of the pharmaceutical companies under investigation and to appoint a judicial administrator as preliminary measures is pending. In February 2007, the Company and the Bari Prosecutor reached an agreement in principle to settle the matter. Under the agreement, which has not yet been finalized, the Company would pay an administrative fine in an amount which is not material to the Company.

Note 22 Subsequent Events

On January 11, 2007, the Company entered into two worldwide (except for Japan) codevelopment and cocommercialization agreements with AstraZeneca PLC (AstraZeneca) to develop and commercialize two investigational compounds being studied for the treatment of type 2 diabetes. The Company received upfront payments of \$100 million from AstraZeneca. In addition, the Company will receive milestone payments from AstraZeneca upon successful achievement of various regulatory and sales related stages. The companies have agreed upon initial development plans for the two compounds. From 2007 through 2009, the majority of development costs will be paid by AstraZeneca and any subsequent development costs will generally be shared equally.

Note 23 Selected Quarterly Financial Data (Unaudited)

Dollars in Millions, Except Per Share Data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2006:					
Net Sales	\$ 4,676	\$ 4,871	\$ 4,154	\$ 4,213	\$ 17,914
Gross Margin	3,200	3,303	2,689	2,766	11,958
Earnings/(Loss) from Continuing Operations ⁽¹⁾	714	667	338	(134)	1,585
Net Earnings/(Loss)	714	667	338	(134)	1,585
Earnings per common share ⁽²⁾ :					
Basic					
Earnings/(Loss) from Continuing Operations ⁽¹⁾	\$ 0.36	\$ 0.34	\$ 0.17	\$ (0.07)	\$ 0.81
Discontinued Operations, net	—	—	—	—	—
Net Earnings/(Loss)	\$ 0.36	\$ 0.34	\$ 0.17	\$ (0.07)	\$ 0.81
Diluted ^{(4) (5) (6)}					
Earnings/(Loss) from Continuing Operations ⁽¹⁾	\$ 0.36	\$ 0.34	\$ 0.17	\$ (0.07)	\$ 0.81
Discontinued Operations, net	—	—	—	—	—
Net Earnings/(Loss)	\$ 0.36	\$ 0.34	\$ 0.17	\$ (0.07)	\$ 0.81
Dividends declared per Common Share	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.28	\$ 1.12
Cash and cash equivalents	\$ 2,477	\$ 2,602	\$ 2,834	\$ 2,018	\$ 2,018
Marketable securities	2,804	2,755	2,671	1,995	1,995
2005:					
Net Sales	\$ 4,532	\$ 4,889	\$ 4,767	\$ 5,019	\$ 19,207
Gross Margin	3,165	3,406	3,284	3,424	13,279
Earnings from Continuing Operations ⁽³⁾	538	991	964	499	2,992
Discontinued Operations, net	(5)	13	—	—	8
Net Earnings	533	1,004	964	499	3,000
Earnings per common share ⁽²⁾ :					
Basic					
Earnings from Continuing Operations ⁽³⁾	\$ 0.27	\$ 0.51	\$ 0.49	\$ 0.26	\$ 1.53
Discontinued Operations, net	—	—	—	—	—
Net Earnings	\$ 0.27	\$ 0.51	\$ 0.49	\$ 0.26	\$ 1.53
Diluted ⁽⁴⁾					
Earnings from Continuing Operations ⁽³⁾	\$ 0.27	\$ 0.50	\$ 0.49	\$ 0.26	\$ 1.52
Discontinued Operations, net	—	—	—	—	—
Net Earnings	\$ 0.27	\$ 0.50	\$ 0.49	\$ 0.26	\$ 1.52
Dividends declared per Common Share	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.28	\$ 1.12
Cash and cash equivalents	\$ 3,311	\$ 1,798	\$ 2,129	\$ 3,050	\$ 3,050
Marketable securities	2,671	1,242	1,652	2,749	2,749

⁽¹⁾ 2006 includes net litigation charges \$40 million and \$353 million in the first and fourth quarters, respectively, and net litigation income of \$14 million and \$29 million in the second and third quarters, respectively. The first, third and fourth quarters include litigation insurance recoveries of \$21 million, \$9 million and \$7 million, respectively. The first, second, third and fourth quarters include restructuring of \$1 million, \$3 million, \$2 million and \$53 million, respectively. The first, third and fourth quarters include upfront and milestone payments of \$18 million, \$17 million and \$35 million, respectively. The first quarter includes \$200 million from the gain on sale of product asset. The first, second, third and fourth quarters include \$50 million, \$21 million, \$72 million and \$43 million, respectively, from accelerated depreciation, asset impairment and contract termination. The fourth quarter includes debt retirement costs of \$220 million. The fourth quarter includes a \$13 million claim for damages.

⁽²⁾ Earnings per share for the quarters may not add to the amounts for the year, as each period is computed on a discrete basis.

⁽³⁾ 2005 includes litigation charges of \$124 million, \$269 million and \$197 million in the first, second and fourth quarters, respectively. The second and third quarters include litigation insurance recoveries of \$295 million and \$26 million, respectively. The first, second, third and fourth quarters include restructuring and other items of \$17 million, \$24 million, \$30 million and \$86 million, respectively. The first and fourth quarters include upfront payments for licensing agreements of \$35 million and \$9 million, respectively. The first and second quarters include \$18 million and \$9 million, respectively, from the gain on sale of equity investments. The first, second and third quarters include \$16 million, \$1 million and \$1 million, respectively, from the loss on sale of fixed assets. The second quarter includes debt retirement costs of \$69 million. The fourth quarter includes \$138 million deferred income, net of costs resulting from the termination of the collaborative agreement with Merck for muraglitazar. The third quarter includes the gain on sale of the Consumer Medicines business of \$569 million.

Bristol-Myers Squibb

⁽⁴⁾ Common equivalent shares excluded from the computation of diluted earnings per share, because the effect would be anti-dilutive, were as follows (in millions):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2006	165	147	146	174	164
2005	142	141	139	156	156

⁽⁵⁾ For the three months ended December 31, 2006, as a result of the net loss, basic and diluted loss per share are equal.

⁽⁶⁾ In 2006, the 29 million weighted-average shares issuable, as well as \$35 million of interest expense, net of tax, on the conversion of convertible debt were not included in the diluted earnings per share calculation because they were not dilutive.

Reports of Management

Management's Responsibility for Financial Statements

Management is responsible for the preparation and integrity of the financial information presented in this Annual Report. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), applying certain estimates and judgments as required. In management's opinion, the consolidated financial statements present fairly the Company's financial position, results of operations and cash flows.

The Audit Committee of the Board of Directors meets regularly with the internal auditors, Deloitte & Touche LLP (D&T), the Company's independent registered accounting firm, and management to review accounting, internal control structure and financial reporting matters. The internal auditors and D&T have full and free access to the Audit Committee. As set forth in the Company's Standard of Business Conduct and Ethics, the Company is firmly committed to adhering to the highest standards of moral and ethical behavior in all of its business activities.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision and with the participation of management, including the chief executive officer and chief financial officer, management assessed the effectiveness of internal control over financial reporting as of December 31, 2006 based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that assessment, management has concluded that the Company's internal control over financial reporting was effective at December 31, 2006 to provide reasonable assurance regarding the reliability of its financial reporting and the preparation of its financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (GAAP). Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Deloitte & Touche LLP, an independent registered public accounting firm, has audited the Company's financial statements included in this Annual Report and has issued its report on management's assessment of the effectiveness of the Company's internal control, which appears on page 108 in this Annual Report.



James M. Cornelius
Chief Executive Officer



Andrew R.J. Bonfield
Chief Financial Officer

February 26, 2007

Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of December 31, 2006, management carried out an evaluation, under the supervision and with the participation of its chief executive officer and chief financial officer, of the effectiveness of the design and operation of its disclosure controls and procedures as such term is defined under Exchange Act Rule 13a-15(e). Based on this evaluation, management has concluded that as of December 31, 2006, such disclosure controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision and with the participation of management, including the chief executive officer and chief financial officer, management assessed the effectiveness of internal control over financial reporting as of December 31, 2006 based on the framework in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that assessment, management has concluded that the Company's internal control over financial reporting was effective at December 31, 2006 to provide reasonable assurance regarding the reliability of its financial reporting and the preparation of its financial statements for external purposes in accordance with United States generally accepted accounting principles. Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Deloitte & Touche LLP, an independent registered public accounting firm, has audited the Company's financial statements included in this report on Annual Report and issued its report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, which is included herein.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended December 31, 2006 that have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Bristol-Myers Squibb Company

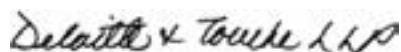
We have audited the accompanying consolidated balance sheet of Bristol-Myers Squibb Company and subsidiaries (the “Company”) as of December 31, 2006, and the related consolidated statements of earnings, comprehensive income and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company for the years ended December 31, 2005 and 2004 were audited by other auditors whose report, dated March 13, 2006, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2006 consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2006, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1, 16 and 20 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, effective January 1, 2006 and SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, effective December 31, 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2007 expressed an unqualified opinion on management’s assessment of the effectiveness of the Company’s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.



Deloitte & Touche LLP
Parsippany, New Jersey
February 26, 2007

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Bristol-Myers Squibb Company

We have audited management's assessment, included in Management's Report on Internal Control Over Financial Reporting, that Bristol-Myers Squibb Company and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

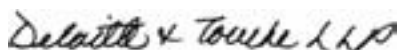
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2006 of the Company and our report dated February 26, 2007 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the Company's adoption of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, effective January 1, 2006 and SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, effective December 31, 2006.



Deloitte & Touche LLP
Parsippany, New Jersey
February 26, 2007

Report of Independent Registered Public Accounting Firm

To the Board of Directors
and Stockholders of
Bristol-Myers Squibb Company:

In our opinion, the consolidated balance sheet as of December 31, 2005 and the related consolidated statements of earnings, comprehensive income and retained earnings, and cash flows for each of the two years in the period ended December 31, 2005 present fairly, in all material respects, the financial position of Bristol-Myers Squibb Company and its subsidiaries at December 31, 2005, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



PricewaterhouseCoopers LLP
Philadelphia, PA
March 13, 2006

Five-Year Financial Summary

Amounts in Millions, Except Per Share Data	2006	2005	2004	2003	2002
Income Statement Data: ⁽¹⁾⁽²⁾					
Net Sales	\$ 17,914	\$ 19,207	\$ 19,380	\$ 18,653	\$ 16,208
Earning from Continuing Operations Before Minority Interest and Income Taxes	2,635	4,516	4,418	4,680	2,748
Earnings from Continuing Operations	1,585	2,992	2,378	3,097	2,059
Earnings from Continuing Operations per Common Share:					
Basic	\$ 0.81	\$ 1.53	\$ 1.23	\$ 1.60	\$ 1.07
Diluted ⁽³⁾	\$ 0.81	\$ 1.52	\$ 1.21	\$ 1.59	\$ 1.06
Average common shares outstanding:					
Basic	1,960	1,952	1,942	1,937	1,936
Diluted ⁽³⁾	1,963	1,983	1,976	1,950	1,942
Dividends paid on common and preferred stock	\$ 2,199	\$ 2,186	\$ 2,174	\$ 2,169	\$ 2,168
Dividends declared per Common Share	\$ 1.12	\$ 1.12	\$ 1.12	\$ 1.12	\$ 1.12
Financial Position Data at December 31:					
Total Assets ⁽⁴⁾	\$ 25,575	\$ 28,138	\$ 30,435	\$ 27,448	\$ 25,106
Cash and cash equivalents	2,018	3,050	3,680	2,549	2,451
Marketable securities	1,995	2,749	3,794	3,013	1,622
Long-term debt	7,248	8,364	8,463	8,522	6,261
Stockholders' Equity ⁽⁴⁾	9,991	11,208	10,202	9,786	8,756

⁽¹⁾ The Company recorded items that affected the comparability of results. For a discussion of these items for the years 2006, 2005 and 2004, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Expenses, Note 2 "Alliances and Investments"; Note 3 "Restructuring"; Note 4 "Acquisitions and Divestitures"; Note 5 "Discontinued Operations"; Note 14 "Short-Term Borrowings and Long-Term Debt"; and Note 21 "Legal Proceedings and Contingencies."

⁽²⁾ Excludes discontinued operations of Oncology Therapeutics Network for years 2002 through 2005; and Clairol and Zimmer in 2002.

⁽³⁾ In 2006, the 29 million weighted-average shares issuable, as well as \$35 million of interest expense, net of tax, on the assumed conversion of convertible debt were not included in the diluted earnings per share calculation because they were not dilutive.

⁽⁴⁾ In 2006, includes the impact of the adoption of Statement of Financial Accounting Standard (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. For further discussion on SFAS No. 158, see Note 20 "Pension and Other Postretirement Benefits."

Board of Directors

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Retired Chairman and Chief Executive Officer, AT&T Corporation (b,c,d)

LEWIS B. CAMPBELL

Chairman, President and Chief Executive Officer, Textron Inc. (a,b,c,d)

VANCE D. COFFMAN

Retired Chairman and Chief Executive Officer, Lockheed Martin Corporation (a,b,c,d)

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Chief Executive Officer, Bristol-Myers Squibb, and Chairman Emeritus, Guidant Corporation (d)

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Irene Heinz Given Professor of Immunology, Harvard School of Public Health, and Professor of Medicine, Harvard Medical School (a,b,e)

MICHAEL GROBSTEIN

Retired Vice Chairman, Ernst & Young (a)

LEIF JOHANSSON

President, AB Volvo, and Chief Executive Officer, The Volvo Group (a,c)

VICKI L. SATO, Ph.D.

Professor of Management Practice, Harvard Business School, and Professor of the Practice in the Department of Molecular and Cell Biology, Harvard University (e)

R. SANDERS WILLIAMS, M.D.

Senior Vice Chancellor for Academic Affairs, Duke University Medical Center, and Dean of Duke University School of Medicine (e)

- (a) Audit Committee
- (b) Committee on Directors and Corporate Governance
- (c) Compensation and Management Development Committee
- (d) Executive Committee
- (e) Science and Technology Committee

Management Council

JAMES M. CORNELIUS

Chief Executive Officer

LAMBERTO ANDREOTTI

Executive Vice President and President, Worldwide Pharmaceuticals

STEPHEN E. BEAR

Senior Vice President, Human Resources

ANDREW R. J. BONFIELD

Executive Vice President and Chief Financial Officer

JOHN E. CELENTANO

President, Health Care Group

SANDRA LEUNG

Senior Vice President and General Counsel

ELLIOTT SIGAL, M.D., Ph.D.

Executive Vice President and Chief Scientific Officer and President, Pharmaceutical Research Institute

Stockholder Information

COMMON STOCK

Ticker symbol: BMY
New York Stock Exchange

ANNUAL MEETING OF STOCKHOLDERS

Tuesday, May 1, 2007
10:00 a.m., Hotel duPont
11th and Market Streets
Wilmington, DE 19801

STOCKHOLDER SERVICES AND PROGRAMS

All inquiries concerning stockholder accounts and stock transfer matters—including address changes, the elimination of duplicate mailings, dividend reinvestment (see below) and direct deposit of dividends—should be directed to the Company's Transfer Agent and Registrar:

MELLON INVESTOR SERVICES LLC

480 Washington Boulevard
Jersey City, NJ 07310-1900
www.melloninvestor.com/isd
800-356-2026 (within the U.S.)
201-680-6578 (outside the U.S.)
TDD telephone service for the hearing-impaired: 800-231-5469 (within the U.S.)
201-680-6610 (outside the U.S.)

DIVIDEND REINVESTMENT PLAN

Registered stockholders (stock must be held in your name) who hold 50 or more shares of the Company's stock may participate in its stockholder-paid Dividend Reinvestment Plan (DRIP), which includes a safekeeping and sale-of-stock feature. If you hold fewer than 50 shares, you are still eligible to participate in the safekeeping and sale-of-stock features as well as the direct registration option.

FORM 10-K

For a free copy of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, contact:
Secretary
Bristol-Myers Squibb Company
345 Park Avenue
New York, NY 10154-0037

Form 10-K is also available at
www.bms.com/investors.

The most recent certifications by the Company's chief executive officer and chief financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits to the Company's Form 10-K. The Company has also filed with the New York Stock Exchange the most recent Annual CEO Certification as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.

Information on the following subjects is available at www.bms.com:

- Bristol-Myers Squibb Foundation
- Sustainability/Environmental Programs
- Political Contributions
- Diversity and EEO-1 Report

This Annual Report contains certain forward-looking information within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve substantial risks and uncertainties that could cause actual results to differ materially from the expectations or estimates reflected in the forward-looking statements. Please see page 49 in the Financial Review for a discussion and description of these risks and uncertainties. The Company undertakes no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise.

PRODUCT NAMES AND COMPANY PROGRAMS

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Norvir is a trademark of Abbott Laboratories.

Trizivir is a trademark of Glaxo Group Ltd.

Truvada is a trademark of Gilead Sciences, Inc.

ON THE BACK COVER:

Clockwise from right: Barbara Cubic with William, age 2, Brennen, age 7, and Alex, age 13. Barbara and her husband, John, adopted William and Brennen from Russia. The boys share a rare inherited metabolic disorder, called PKU. Together, they prevail with the help of Mead Johnson's *Phenyl-Free 2* and *Phenyl-Free 2 HP* dietary powders.

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Bristol-Myers Squibb Corporate and Business
Communications Department. Photo on page 12,
Syracuse facility, by Ron Trinca.

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Bristol-Myers Squibb

Together we can prevail.™